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No. 82-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE ANACONDA COMPANY, a Corporation, on its own behalf and as successor by merger to ANACONDA AMERICAN BRASS COMPANY, ANACONDA WIRE AND CABLE COMPANY, ANACONDA ALUMINUM COMPANY, and ANACONDA ELECTRONICS COMPANY,

Appellant,

v.

THE FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Appellee.

ON APPEAL FROM THE COURT OF APPEAL OF THE STATE OF CALIFORNIA FOR THE FIRST APPELLATE DISTRICT

JURISDICTIONAL STATEMENT

GEORGE E. LINK
Counsel of Record

PETER ANDERSON
R. TYLER ANDERSEN
Two Embarcadero Center
San Francisco, CA 94111
Telephone: (415) 392-6320

Counsel for Appellant
The Anaconda Company

Of Counsel:
THELEN, MARRIN, JOHNSON & BRIDGES
Two Embarcadero Center
San Francisco, CA 94111
Telephone (415) 392-6320

August 20, 1982.

QUESTIONS PRESENTED

Does requiring the before-tax income of overseas subsidiaries of a U.S. corporation doing business in California to be included in the parent corporation's tax base for determining the business income to be apportioned to California for purposes of the California franchise tax violate the foreign commerce and due process clauses of the United States Constitution, and conflict with well established federal tax policy, when:

1. The inclusion of the overseas subsidiaries' income in the California tax base results in severe double taxation of such income;

2. The overseas subsidiaries do not conduct any business operations in the United States, are not part of a functionally integrated business with the parent corporation and its California operations, and are extensively regulated and controlled by foreign governments; and

3. The inclusion of the overseas subsidiaries' income in the California tax base and the apportionment of such income by means of the standard three-factor apportionment formula result in a significant misattribution of income to California.

PARTIES

The caption of the case in this Court contains the names of all parties to the proceedings in the Court of Appeal of the State of California for the First Appellate District (the "Court of Appeal"). Pursuant to Rule 28.1 of the Rules of this Court, a list of appellant's parent and non-wholly owned subsidiaries and affiliates is set forth in Appendix A below.

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No. 82-

In The

Supreme Court of the United States

October Term, 1982

The Anaconda Company, a Corporation, on its own behalf and as successor by merger to Anaconda American Brass Company, Anaconda Wire and Cable Company, Anaconda Aluminum Company, and Anaconda Electronics Company,

Appellant,

v.

The Franchise Tax Board Of The State Of California,

Appellee.

ON APPEAL FROM THE COURT OF APPEAL OF THE STATE OF CALIFORNIA FOR THE FIRST APPELLATE DISTRICT

JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Court of Appeal is reported at 130 Cal.App.3d 25, 181 Cal. Rptr. 640 (1981), and is printed in Appendix B. The Findings of Fact and Conclusions of Law of the California Superior Court, City and County of San Francisco, are not reported. They are printed in Appendix C.

JURISDICTION

The Court of Appeal issued its opinion and judgment on March 24, 1982, reversing the California trial court's judgment in favor of appellant. This opinion was rendered pursuant to

the grant of a rehearing to appellant on December 28, 1981. The grant of the rehearing is reprinted in Appendix D. Appellant's petition for hearing in the California Supreme Court was filed on April 30, 1982, and was denied May 26, 1982. This denial is reprinted in Appendix E.

A notice of appeal was filed in the Court of Appeal on July 9, 1982. This notice is reprinted in Appendix F. The time within which to docket this appeal in this Court expires on August 24, 1982, and a timely docketing has been made. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1257(2). Appellant squarely challenged the constitutionality of the California Revenue and Taxation Code, as construed to require worldwide combined tax reporting, and the Court of Appeal squarely sustained its validity, as so construed.

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

This case involves claims under the Commerce Clause and the Due Process Clause of the Fourteenth Amendment of the United States Constitution. The applicable constitutional provisions are:

> Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes. [Art.I, Section 8, cl.3]
>
> . . . nor shall any State deprive any person of life, liberty, or property, without due process of law . . . [XIV Amend., Section 1]

California Revenue and Taxation Code Section 25101 and related sections as they appeared during the tax years at issue (1955-1969), and California Administrative Code, Title 18, Section 25120(b) are set forth in Appendix G.

STATEMENT OF THE CASE

This case involves the same issues of state income taxation as are presently before the Court in *Container Corporation of America v. Franchise Tax Board*, 117 Cal.App. 3d 988, 173

Cal.Rptr. 121 (1981), *prob. jur. noted,* ____U.S.____ , 102 S.Ct. 2034 (1982), and *Chicago Bridge & Iron Company v. Caterpillar Tractor Co.*, 84 Ill.2d 102, 417 N.E.2d 1343, *prob. jur. noted,* ____U.S.____ , 102 S.Ct.564(1981). Indeed, the Court of Appeal in this case based its decision principally on the same court's earlier decision in *Container Corporation.* (Appendix B, *infra,* A-20) The question in all of these cases is whether a state may tax, under the unitary business concept, income of foreign operating subsidiaries engaged in business exclusively outside the United States.

Appellant, The Anaconda Company ("Anaconda"), was a Montana corporation during the tax years at issue (1955-1969), with its corporate headquarters located in New York City. Anaconda owned and operated a number of copper mines and other mineral properties in the western United States, and also had several domestic subsidiaries engaged in other aspects of the copper business. Among these were Anaconda Sales Company ("Anaconda Sales"), a marketing affiliate, and Anaconda American Brass Company ("American Brass") and Anaconda Wire and Cable Company ("Wire and Cable"), which were both domestic copper fabricators. In addition, Anaconda had three Chilean subsidiaries and a Mexican subsidiary (the "Latin American companies") engaged in the production and processing of copper entirely outside the United States.

None of the Latin American companies conducted business within the United States. The sole domestic presence of any of the companies was an administrative office maintained by one of the Chilean subsidiaries in New York City. This office performed accounting and financial services for the Chilean companies, and also housed a small personnel department established to recruit job applicants for assignment to Chile or Mexico. Additionally, several officers of the Latin American companies were based in New York and the boards of directors of the Chilean companies met in New York. The directors were representatives of Anaconda, the principal shareholder.

Aside from these peripheral contacts, the Latin American companies operated entirely outside the country. They did not own any commercial property in the United States; they did not

conduct any mining or sales activity here; and they did not maintain any other type of industrial facility. The companies had no presence whatsoever in the State of California.

The limited administrative and operational relationships between the Latin American companies and the Anaconda domestic group occurred completely outside of California. At the administrative level, the parent company performed general corporate services for the Latin American companies in New York. These included U.S. federal tax accounting, insurance services, data processing, purchasing and financial services. In terms of the total operating expenditures of the Latin American companies, however, such services were relatively insignificant, amounting to a yearly average of less than two percent of each company's total operating costs. Anaconda had no corporate offices in California during the years at issue and no such services were performed from California.[1]

At the operational level, the Anaconda engineering and geology departments in New York occasionally provided consulting services to the Latin American companies, and the production of the Chilean companies was marketed by Anaconda Sales to the extent of exports from Chile. Also, during the years at issue, a portion of the copper produced in Chile was sent to an Anaconda subsidiary in Perth Amboy, New Jersey for refining. As Chilean refining capacity increased during the 1950's and early 1960's, however, this relationship declined in relative terms, such that by that late 1960's the major portion of Chilean production was refined locally.

The Chilean companies sold their production primarily on the world market to industrial users in Western Europe. An annual average of over 70 percent of the companies' production was delivered to unaffiliated purchasers in the European market. An additional 2 to 11 percent of Chilean copper was sold within Chile, and almost all of the production of the Mexican

[1] Indeed, Anaconda itself was only present in California as a result of its ownership of several small mines producing minerals other than copper. Anaconda had no administrative or executive offices in the State, nor did it conduct any other California business relating to copper. American Brass and Wire and Cable, however, both had fabricating plants in California, as well as warehouses and sales distribution centers established to service the California market for manufactured copper products.

company was sold locally within Mexico. The balance of Chilean production was marketed either in other Latin American countries or in the United States, a portion being sold to Anaconda's fabricating subsidiaries, American Brass and Wire and Cable. All such transactions with the Anaconda domestic group occurred at the prevailing U.S. price for Chilean copper and, like domestic U.S. sales, involved a fungible commodity indistinguishable as to source or producer.

No sales of Chilean or Mexican copper were made for delivery to California, however, nor was any sales activity conducted for or on behalf of the Latin American companies in California. As a result, Anaconda's California operations (and the operations of Anaconda's California affiliates) had no commercial dealings whatsoever, either on a direct or indirect basis, with the producing companies in Chile or Mexico.

The operations of Anaconda's Latin American companies were extensively regulated and controlled by the respective Governments of Chile and Mexico. In order to control the operations of its foreign-owned producers, Chile established in 1955 a government agency designed solely to supervise and regulate the nation's copper industry. Called the "Copper Department" (later changed to the "Copper Corporation" or "Codelco"), this agency was an independent organization with full legal power to conduct business and enter into contracts for its own account, in addition to its regulatory powers. The Copper Department was given extensive powers over the Chilean companies, including the power to control all exports of copper and imports of goods and equipment, the power to set copper prices and the terms and conditions of sale, the power to make sales directly on behalf of the producing companies, and the power to regulate working conditions and operations at the mines. Decisions of the Copper Department were binding on the companies without right of judicial appeal. A similar set of controls existed in Mexico, including the strict regulation of copper sales and exports. Such controls in Chile culminated in the eventual expropriation of Anaconda's Chilean mining properties in 1971. Likewise, Anaconda was compelled by local law to divest itself of majority ownership in its Mexican mining subsidiary in 1971.

In addition to being closely regulated at the operational level, all of Anaconda's Latin American companies were subject to heavy income taxation by the host government. In each case, taxes were assessed on an unapportioned basis, without deduction or credit allowed for taxes paid outside the country. Moreover, since net taxable income was defined more broadly under Chilean law in particular than under U.S. law, the actual burden of Chilean taxation in U.S. terms ran as high as ninety percent of U.S. taxable income.

During the tax years at issue, both Anaconda and several of its domestic subsidiaries were doing business in California. Each such domestic company was therefore required by California law to file a tax return with respect to its California operations. Anaconda submitted franchise tax returns for this group computed on the basis of a combined unitary business. Defining the unitary business to include not only its companies operating in California but also its entire domestic copper group, Anaconda determined its California tax on the basis of a combined group consisting of approximately twenty-five affiliated companies operating throughout the continental United States. Anaconda apportioned a part of the business income of this domestic group to California by means of the standard payroll, property and sales factors formula.

The California Franchise Tax Board (the "Franchise Tax Board"), however, required that the group be extended still further to include Anaconda's Latin American companies, despite the undisputed fact that these foreign companies had no direct or indirect contacts whatsoever with California. The Franchise Tax Board thus included in unitary business income large amounts of foreign operating income already fully taxed by the governments of Chile and Mexico. The Board then applied its three-factor apportionment formula to a combined yearly sum consisting of both U.S. domestic income and this before-tax Latin American income.

Anaconda commenced this refund action on March 7, 1975, in the Superior Court of the State of California for the City and County of San Francisco. The complaint was based

upon claims for refund and protests previously filed by Anaconda and denied by the Franchise Tax Board. The claims demanded refunds upon the basis of California law not relevant to this appeal and upon the grounds that the state is prohibited from including the Latin American companies in a unitary return with Anaconda under the due process and foreign commerce clauses of the United States Constitution. In addition to raising such constitutional issues in its complaint, appellant fully briefed its claims both before the trial court and the Court of Appeal.

Basing its decision upon California law and thus leaving open the federal constitutional questions, the trial court determined that Anaconda and its domestic subsidiaries were not engaged in a single unitary business with the Latin American companies. (Appendix C, *infra*, A-61.) The Court of Appeal reversed the judgment of the trial court and specifically rejected each of appellant's due process and foreign commerce clause claims on the basis of the Court's earlier decision in *Container Corporation of America v. Franchise Tax Board.* (Appendix B, *infra*, A-20).

REASONS WHY QUESTIONS PRESENTED ARE SUBSTANTIAL

The questions presented by this appeal are so substantial as to require plenary consideration by the Court, with briefs on the merits and oral argument, for their resolution. Like the other two foreign commerce unitary business cases currently on appeal to the Court,[2] this case presents three vitally important state tax issues which have not been decided by the Court and which are of pressing concern to multinational taxpayers, such as appellant.

The first of these issues is whether a state, on a unitary business basis, may constitutionally include within its income tax base the worldwide income of a multinational group of companies notwithstanding the fact that foreign income of the group has been subject to a full unapportioned tax abroad. In

[2] *Container Corporation of America v. Franchise Tax Board*, and *Chicago Bridge & Iron Company v. Caterpillar Tractor Co.*

Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979), this Court held that a similar state property tax, as applied to containers owned by Japanese shipping companies, failed to meet the requirements of the commerce clause. Despite the identical policy considerations involved in the application of state corporate income taxes, the Court of Appeal in this case relied on its holding in *Container Corporation*, which construed *Japan Line* as limited solely to property taxation. Appellant submits that this is a serious misreading of *Japan Line*, requiring correction by this Court.

The second and equally vital issue concerns the constitutional validity of the unitary business concept as applied to government controlled foreign operating companies having no functional relationships with the taxing state. California in this case has relied exclusively upon the minimal contacts between appellant's Latin American companies and its U.S. domestic operations outside of California. However, no functional integration nor series of business transactions exists which links California to Anaconda's Latin American companies. While this Court's recent decisions in *ASARCO Incorporated v. Idaho State Tax Commission*, ____U.S.____ , 50 U.S.L.W. 4962 (1982), and *F. W. Woolworth Co. v. Tax. and Rev. Dept. of New Mexico*, ____U.S.____ , 50 U.S.L.W. 4957 (1982) appear to limit the unitary business concept in the context of apportioning investment income, the Court has not squarely addressed the unitary issue in the context of combined reporting.

The Court has also not addressed the third issue of income distortion and misapportionment arising from application of the standard three-factor apportionment formula to the income of foreign subsidiaries operating under economic conditions vastly different from those in the United States. As a result of the Franchise Tax Board's failure to take account of any of the unique aspects of doing business in Chile and Mexico, large amounts of Latin American income have been wrongly attributed to production sources in California, even if it were to be assumed that some Latin American income could be attributed to California.

Finally, it should be emphasized that the questions presented by this appeal are of compelling national and international importance. The state taxes at issue in this case

alone are in excess of $3 million. While California has long been in the forefront in requiring combined reporting on a worldwide basis, a number of other states have recently adopted or are considering similar practices.[3] Fiscal barriers to international trade and investment are thus multiplying, as the prospect of severe international double taxation increases. At the same time, federal tax policy, based upon the internationally accepted arm's length method of income allocation, is contravened. The time is appropriate for this Court to resolve these important constitutional questions.

A. Inclusion of the Latin American Companies in the California Tax Base Results in Impermissible Double Taxation Under *Japan Line*

A requirement of any tax assessed against a multistate (or multinational) taxpayer is that the tax not discriminate against interstate (or foreign) commerce. Discrimination in this regard may consist of either burdening interstate (or foreign) commerce with measures which favor or protect local intrastate business (*see, e.g., Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977)), or subjecting commerce to the burden of multiple taxation (*see, e.g., Gwin v. Henneford*, 305 U.S. 434 (1939)). This Court has recently held, moreover, in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), that in cases involving foreign commerce an even stricter standard of protection is required. In *Japan Line*, the Court found that even though a local property tax was fairly apportioned and non-discriminatory with respect to interstate commerce, its effect upon foreign commerce was such as to constitute an impermissible state interference with matters reserved to the federal government. Rejecting the state's argument that "the Commerce Clause analysis is identical, regardless of whether interstate or foreign commerce is involved," *id.* at 446, the Court ruled that: "When construing Congress' power to 'regulate Commerce with foreign Nations', a more extensive constitutional inquiry is required." *Id.*

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[3] *See* D. S. Harnack and R.A. Hanson, *The Continuing Controversy Over Combination*, 59 TAXES 531 (August, 1981).

The Court in *Japan Line* went on to formulate a special two-part test that must be met by a state tax on foreign commerce. As summarized by the Court:

> In addition to answering the nexus, apportionment, and nondiscrimination questions posed in [an interstate case], a court must also inquire, first, whether the tax notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.' If a state tax contravenes *either* of these precepts, it is unconstitutional under the Commerce Clause. [*Id.* at 451 (emphasis added).]

It follows that if either multiple taxation or a threat to federal uniformity exists in the present case, the policies enunciated in *Japan Line* should be applied to invalidate the California tax at issue herein.

There is no dispute, moreover, that the Latin American income sought to be taxed herein has been subject to serious multiple taxation. As in *Japan Line*, "California's tax . . . creates more than the *risk* of multiple taxation; it produces multiple taxation in fact". *Id.* at 452 (emphasis in original). This much is a matter of record. The parties have thus stipulated that:

> During the years at issue, the Latin American companies were subject to local income taxation on their entire corporate net income, as "net income" was defined for Chilean or Mexican tax purposes. Neither Chile nor Mexico allocated any portion of such income to any other state or country. Moreover, neither host country allowed any deduction, credit or other adjustment for taxes paid to any other state or country. *Accordingly, the entire net income of the Latin American companies at issue in this action constitutes income previously taxed by either Chile or Mexico.* [Stipulation, section 5(i)(a), page 33 (emphasis added).[4]]

[4] The reference is to the Stipulation of Facts (the "Stipulation") found in the Clerk's Transcript on Appeal ("CT") at 611. Appellant will request that the record in the case be transmitted to the Court.

It should be remembered in this regard that such Latin American income was not only subject to unapportioned taxes in the host country, but in the case of Chile was taxed at levels far exceeding rates in the United States. It has also been stipulated that in computing the California tax, the Franchise Tax Board included the income of the Latin American companies without any adjustment, credit or deduction whatsoever for such Latin American taxes. (*See* Stipulation section 8(b)(3), page 41 (CT:619).)

The present case thus squarely raises the issue of the international multiple taxation condemned in *Japan Line*, "where true apportionment does not exist and cannot be policed by this Court. . . ." *Id.* at 455. At the same time, the case also involves the impairment of federal uniformity issue addressed in *Japan Line*. As the Court observed:

> A state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways. If the State imposes an apportioned tax, international disputes over reconciling apportionment formulae may arise. If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. Such retaliation of necessity would be directed at American transportation equipment in general, not just that of the taxing State, so that the Nation as a whole would suffer. If other States followed the taxing State's example, various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from 'speaking with one voice' in regulating foreign commerce. [441 U.S. at 450-51.]

The application of these principles to the worldwide unitary approach followed by California has been discussed at length in the jurisdictional statements submitted to this Court by appellants in *Container Corporation*[5] and *Chicago Bridge & Iron Company*,[6] and by the Justice Department in its Memorandum for the United States as Amicus Curiae in *Chicago*

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[5] Jurisdictional Statement of Appellant, at 12-15 and 24-27, in *Container Corporation of America v. Franchise Tax Board*, No. 81-523 (1981).

[6] Jurisdictional Statement of Appellant, at 18-24, in *Chicago Bridge & Iron Company v. Caterpillar Tractor Co.*, No. 81-349 (1981).

Bridge & Iron Company.[7] As indicated therein, the United States and most foreign nations use the arm's-length method of allocating income between corporations. This method is required under numerous treaties to which the United States is a party and is the recognized international standard for income apportionment. In utilizing a different approach to determining taxable income, California has clearly created a situation where "international disputes over reconciling apportionment formulae may arise . . . [and where] foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions." *Japan Line*, 411 U.S. at 450.

This conflict with the prevailing international tax structure is evidenced by the numerous foreign governmental protests against unitary apportionment which are described in the Justice Department's *amicus* brief in *Chicago Bridge & Iron Company*. As the Department observes:

> [The] unitary method impairs the otherwise uniform international custom that is the basis of the treaties between the United States and numerous foreign countries that are intended to prevent international double taxation of income. Indeed, the Secretary of the Treasury and the Secretary of State have recently received diplomatic communications from the Governments of Great Britain and Canada, complaining about the state unitary method and emphasizing its incompatibility with international practice . . . . Similarly, as appellant points out . . ., all nine members of the European Common Market joined in a *demarche* emphasizing the incompatibility of worldwide combined reporting with internationally accepted rules and principles of the OECD. . . . In this respect, the amicus Union of Industries of the European Community points out that the application of the state unitary method may violate certain treaties of friendship, commerce and navigation.[8]

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[7] Memorandum for the United States as Amicus Curiae, *Chicago Bridge & Iron Company* v. *Caterpillar Tractor Co.*, No. 81-349 (1982).

[8] *Id.* at 10.

Similarly, the Assistant Secretary of the Treasury for Tax Policy, Donald C. Lubick, testified before the House Ways and Means Committee on March 31, 1980 that:

> The practice [of worldwide combined reporting] has created, and continues to create, an irritant in the international relations of the United States. A number of foreign governments have complained, both officially and informally, that the unitary system differs from the arm's-length method used by the Federal Government and generally accepted in international practice.[9]

By requiring a worldwide combined report in the present case, California has thus continued a practice which "creates an asymmetry in the international tax structure" (*Japan Line*, 441 U.S. at 450) and conflicts sharply with federal tax policy. At the same time, the tax at issue herein gives rise to stipulated and undisputed double taxation in an international context where this Court has stated that: "Even a slight overlapping of tax — a problem that might be deemed *de minimis* in a domestic context — assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Id.* at 456. Appellant submits, therefore, that both elements of the commerce clause test set forth in *Japan Line* combine to require reversal of the Court of Appeal's decision in this case.

B. The Inclusion of the Latin American Companies in the California Tax Base also Exceeds the Limitations Imposed by the Due Process Clause as Further Defined by This Court's Recent Decisions in *ASARCO* and *Woolworth*.

An additional requirement of any tax assessed on a unitary basis is that a sufficient nexus exist between the taxing state and the activity or income sought to be taxed. *See, e.g., Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980); and *Mobil Oil Corporation v. Vermont*, 445 U.S. 425 (1980). As described by the Court in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 464 (1958), this requirement of due process is that: "The taxes imposed [be] levied only on the portion of the taxpayer's net income which arises from its activities within the taxing State. These

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[9] *Hearings on H.R.5076 Before the House Committee on Ways and Means*, 96th Cong. 2d Sess. 3, 7 (1980).

activities form a sufficient nexus between such a tax and transactions within a state for which the tax is an exaction." Yet, in the present case, it is clear that California has done more than tax net income arising from "activities within the taxing State." Given the undisputed fact that California had no direct or indirect contacts whatsoever with Anaconda's Latin American companies, neither with respect to the production of raw copper nor with respect to the sale or use of refined copper, it is difficult to conceive of any realistic argument establishing that the income earned by such companies in Latin America arose from activities in California.

Indeed, the only possible nexus with the state is that Anaconda and its California affiliates engaged in a limited number of intercorporate transactions with the Latin American companies wholly outside of California. These extraterritorial transactions, however, were completely unrelated to the activities of the Anaconda group within California. While Anaconda's California copper business consisted only of fabricating refined domestic production and marketing such fabricated products within California, the income of the Latin American companies arose entirely from the production and processing of raw copper mined in Chile or Mexico. No sales or deliveries of Latin American production were made in California, nor did Anaconda's domestic fabricators utilize in California any Latin American production purchased outside of the state. Furthermore, there is no evidence of any exchange of services between California and Latin America, or of any other point of contact between the California portion of Anaconda's domestic business and the operations of the Latin American companies. In the absence of any showing that Latin American income was even remotely related to Anaconda's activities in California, it is immaterial that Anaconda's activities elsewhere in the United States may have contributed in some limited degree to Latin American income. The critical point for purposes of applying the due process clause is that *California itself* (separate and apart from New York, New Jersey or elsewhere) can claim no nexus whatsoever with the income or operations of the Latin American companies.

The recent unitary business decisions of this Court (two of which were issued subsequent to the Court of Appeal's decision herein) confirm this due process analysis. Thus, in *Exxon Corporation v. Wisconsin Department of Revenue*, the Court held that the due process clause did not prevent Wisconsin from taxing a multistate domestic oil business on a unitary or apportioned basis where the out-of-state portions of the business were actually utilized for purposes of supplying products marketed within the state. Similarly, in *Mobil Oil Corporation v. Vermont*, the Court concluded that dividends paid by a number of foreign operating subsidiaries could be apportioned on a unitary basis with the taxpayer's income derived from marketing activities conducted within the taxing state in the absence of any showing that the foreign subsidiaries did not directly contribute to such marketing operations. Indicating that the "linchpin of apportionability in the field of state income taxation is the unitary business principle" (445 U.S. at 439), the Court framed its due process rule as follows:

> [W]hat appellant must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that *the income was earned in the course of activities unrelated to the sale of . . . products in that State.* Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business. [445 U.S. at 439-440 (emphasis added).]

Expanding on the analysis in *Exxon* and *Mobil*, the Court's decisions in June in *ASARCO Inc. v. Idaho State Tax Commission*, and *F. W. Woolworth Co. v. Taxation and Revenue Department*, clearly indicate that unitary treatment cannot be based solely on the grounds that foreign subsidiaries are engaged "in the same general line of business" as the taxpayer. *ASARCO*, 50 U.S.L.W. at 4968 n. 24. Rather, there must be a finding of functional integration with the foreign subsidiaries, a "'series of transactions' . . . linking the . . . business of

[taxpayer's] foreign subsidiaries with its business in [the taxing state]." *Woolworth*, 50 U.S.L.W. at 4961 n. 24.[10]

In the present case, however, appellant has plainly "sustained its burden of proving [an] unrelated business activity on the part of its subsidiaries and affiliates . . . ." *Mobil*, 445 U.S. at 442. As indicated above, it is undisputed that the income of the Latin American companies "was earned in the course of activities unrelated to the sale of . . . products in [California]." *Id.* at 429. There was no series of transactions linking the business of the Latin American companies with Anaconda's business in California. Similarly, it is undisputed that the only relations between the Latin American companies and the United States consisted of transactions wholly unrelated to Anaconda's California copper business. For this reason, the activities of the Latin American companies "[had] nothing to do with the activities of [Anaconda] in the taxing State" (*id.* at

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[10] A second important requirement for unity, emphasized in both Exxon and the Court's most recent decisions, is the presence of "an umbrella of centralized management and *controlled interaction*". *Exxon*, 447 U.S. at 224 (emphasis added). In *ASARCO*, moreover, the Court held that a 51.5% Peruvian mining subsidiary was not part of taxpayer's unitary business principally because ASARCO lacked effective control of the company. In reaching this conclusion, the Court disregarded, for unitary purposes, many of the same intercompany administrative and clerical services as are relied upon by the Franchise Tax Board in this case. 50 U.S.L.W. at 4966 nn. 16 & 17.

The same lack of effective control also exists in the present case as a result of the continuing intervention of the respective host governments in Chile and Mexico. The trial court thus found, after eight days of testimony devoted primarily to the issue of unitary control of the Latin American companies, that:

> "The overall effect of the controls [in Chile] . . . was that the Chilean government itself became a full fledged participant in the business of Anaconda's Chilean companies. Even prior to its acquisition of a stock interest in 1969, the government exercised such *de facto* ownership rights that Anaconda cannot be said to have possessed the unilateral powers of policy making and operational control normally exercised by a majority stockholder with controlling ownership. While the Anaconda domestic group in the United States was linked together by a single ownership interest, this linkage did not extend to the Chilean companies which at all times were responsive to the dual interests of the Chilean government and the parent company." [Appendix C, *infra* A-50.]

A similar finding was made with respect to the controls exercised by the Mexican government. [*Id.* at A-56.]

442), requiring as a matter of due process that the income of such companies be excluded from the California tax base. In holding to the contrary and basing its decision in large part on "a strong inference of a unitary business . . . where the taxpayer is engaged in the same type of business [as its subsidiaries]" (Appendix B, *infra*, A-18 and 19), the Court of Appeal in this case followed a due process standard wholly at odds with that established by this Court.

C. Even if Anaconda's Latin American Companies were Unitary with its U.S. Domestic Business for the Years at Issue, the Methods used by the Franchise Tax Board to Apportion Unitary Business Income to California Result in the Inclusion within the California Tax Base of Extraterritorial Values in Violation of the Due Process Clause.

Two tax consequences follow from the Court of Appeal's determination that Anaconda and its Latin American companies were engaged in a single unitary business. First, the business income of the Latin American companies is added to the total unitary business income of the Anaconda domestic group; and second, various values associated with Latin American production are included in the three-factor apportionment formula used by the Franchise Tax Board to allocate a share of such income to California.[11] In upholding the Board's actions in this regard, the Court of Appeal recognized no differences between Anaconda's domestic subsidiaries and its Latin American companies.

Appellant contends, as a matter of due process, that proper recognition should be given in the apportionment formula to the vast differences in production values and business conditions as between the United States and Latin America. As will be demonstrated, this disparity otherwise results in an

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[11] In formula terms, the method employed by the Franchise Tax Board in the present case is as follows:

$$\text{California Income} = \text{Total Unitary Income (U.S. plus Latin American)} \times \frac{\text{Calif. Payroll}}{\text{Total Payroll}} + \frac{\text{Calif. Property}}{\text{Total Property}} + \frac{\text{Calif. Sales}}{\text{Total Sales}}$$

apportionment of income to the state far in excess of any amount reasonably attributable to Anaconda's California operations.

There are no decisions of this Court which have considered the constitutionality of the three-factor apportionment formula as applied to the income of foreign subsidiaries engaged in business exclusively outside the United States. Indeed, the taxpayer in *Mobil Oil Corp. v. Vermont*, 445 U.S. 425 (1980) specifically "disclaimed any dispute with the accuracy or fairness of Vermont's [three-factor] apportionment formula" as applied to the foreign source income at issue therein. *Id.* at 434. It is well established generally, however, that a formula valid on its face may nevertheless be prohibited under the due process and commerce clause to the extent that its use in a specific case results in the taxation of extraterritorial values. As observed by the Court in *Norfolk & Western Railway Co. v. Tax Commission*, 390 U.S 317, 325-27 (1968):

> A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to 'project the taxing power of the state plainly beyond its borders.' *Nashville, C.& St.L.R. Co. v. Browning*, 310 U.S. 362, 365 (1940). Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State . . . . The facts of life do not neatly lend themselves to the niceties of constitutionalism; but neither does the Constitution tolerate any result, however distorted, just because it is the product of a convenient mathematical formula which, in most situations, may produce a tolerable product.

In the context of the present case, moreover, there can be little question that California's indiscriminate combination of domestic and international values yields the very type of "grossly distorted result" condemned in *Norfolk* (320 U.S. at 329). At a general level, this is evident from the nature of the foreign investments involved. Obviously, a foreign shareholder such as Anaconda would be unwilling to invest the enormous amounts required by its Latin American companies, subject at

all times to a high degree of political as well as economic risk, were it not for the prospect of productivity values far more favorable than those existing in the United States. In this regard, the principal investment incentive was precisely the dramatic deviation from U.S. values. To in turn treat such an investor in the same manner as a taxpayer with holdings located solely in the United States is to blindly ignore economic reality in favor of "any result, however distorted, . . . [which] is the product of a convenient mathematical formula . . . ." *Norfolk*, 320 U.S. at 327.

More specifically, such distortion can be seen in terms of the actual values used in the three-factor apportionment formula. Thus, the average payroll cost (as payroll is defined for formula purposes) of Anaconda's Latin American companies over the fifteen years at issue consisted of approximately $.05 per pound of refined copper, an amount representing only about 32 percent of Anaconda's average payroll per pound of refined copper in the United States.[12] Broken down over the 1955-1969 period, Latin American payroll rates ranged from 50 percent of the U.S. rate in 1969 to as little as 17 percent of the U.S. rate in 1956. In the three-factor formula, however, payroll in the United States is treated as equally productive (or equally representative) of income as payroll in Latin America. The result, of course, is that a large amount of Latin American production income is recast as income "attributable" to California payroll.

Similarly, due in part to the extremely rich ore deposits in Latin America, the relative investment in tangible property (as defined for formula purposes) was considerably less than in the United States. Thus the 1955-1969 average investment in tangible property per pound of refined copper in Latin America constituted less than 60 percent of the corresponding figure for Anaconda's operations in the United States.[13] As with payroll, this varied from 74 percent in 1958 to an investment of only 27 percent in 1967. Yet again, in the three-factor formula, U.S.

[12] *See* section 6 and Exhibit I of the Stipulation (CT:613-15 and 657) for a yearly breakdown of the payroll values discussed in this paragraph.

[13] *See* section 6 and Exhibit J of the Stipulation (CT:613-15 and 659) for a yearly breakdown of the property values discussed in this paragraph.

property values and Latin American values are viewed as equally productive of income, the result being that a disproportionate amount of Latin American earnings are attributed to property in California.

On an overall basis, such deviations in value resulted in the total cost per pound of refined copper sold by the Latin American companies averaging only about 66 percent of the comparable cost in the United States.[14] Correspondingly, given this production savings combined with the divergent market conditions for Latin American production, before tax profits per pound of refined copper in Latin America averaged over 3 times greater than in the United States, ranging as high as an extraordinary 57 times greater in the year 1963.[15] Yet, in the Franchise Tax Board's formula, total Latin American production inputs are weighed equally with U.S. domestic inputs as if the income represented by each California dollar of cost were exactly the same as that represented by a Latin American dollar.

Clearly this result is constitutionally unacceptable. Over and above the gross economic exaggeration inherent in equating California (or even U.S.) productivity with that of a region possessing the richest known copper deposits in the world, such an equation runs squarely against the established constitutional limitations imposed by the due process and commerce clauses. To paraphrase the Court in *Norfolk*, California "by ignoring the peculiarities of a given enterprise" has projected "the taxing power of the state plainly beyond its borders." 390 U.S. at 325.

It should be noted in closing that the foregoing discussion concerning the three-factor formula also serves to underscore Anaconda's basic position herein concerning the unitary treatment of the Latin American companies. While the peculiarities of the Latin American enterprise lead to a serious distortion of apportionment values, such differences indicate at the same

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[14] *See* section 6 and Exhibit L of the Stipulation (CT:613-15 and 663) for a yearly comparison of total costs.

[15] *See* section 6 and Exhibit M of the Stipulation (CT; 613-15 and 665) for a yearly comparison of before tax profits. Such Latin American profits were offset, of course, by the high rates of taxation existing in Chile and Mexico (with respect to which no recognition has been accorded by the Franchise Tax Board).

time that this case involves several wholly separate businesses functioning under widely diverse economic conditions. The fact that the standard three-factor formula is deficient in such a setting follows as a matter of course from the fact that the unitary business concept itself was not designed to cover such a taxpayer. Originating as a method of taxing multistate dry goods sellers and domestic manufacturers (*see Underwood Typewriter Company v. Chamberlain*, 254 U.S. 113 (1920), and *Butler Brothers v. McColgen*, 17 Cal.2d 664, 111 P.2d 334 (1941), *aff'd* 315 U.S. 501 (1942)) the unitary concept with its three-factor formula bears little relation to the business of a state dominated copper concessionaire operating in the deserts of central Chile. For this reason, as well as the reasons discussed above, the income of the Latin American companies should be excluded altogether from the California tax base.

CONCLUSION

Anaconda respectfully requests the Court to note probable jurisdiction of this appeal and to consolidate the case for hearing with *Container Corporation* and *Chicago Bridge & Iron*.

Dated: August 20, 1982

Respectfully submitted,

GEORGE E. LINK
Counsel of Record

PETER ANDERSON
R. TYLER ANDERSEN
Counsel for Appellant
The Anaconda Company

Of Counsel:
THELEN, MARRIN, JOHNSON & BRIDGES

APPENDIX A

THE ANACONDA COMPANY

Parent and Non-Wholly Owned Subsidiaries and Affiliates of the Anaconda Company

Parent: ATLANTIC RICHFIELD COMPANY

Subsidiaries and Affiliates:

ABE Beverage, Inc.
Acerlan, S.A. de C.V.
Alambres y Cables de Panama, S.A.
Alpart Farms (Jamaica), Ltd.
Alumina Contractors, Ltd.
Alumina Partners of Jamaica
Alyeska Pipeline Service Company
Ambler Mining Company
Anaconda-Ericsson, Inc.
Anaconda Exploration New Zealand Ltd.
Anaflex, S.A. de C.V.
Anamax Mining Company
Anamet S.A. de C.V.
ARCO Australia Coal Pty. Ltd.
ARCO Belgium S.A.
ARCO Oil Limited
ABRCOBrasil Participacoes Investmentos Ltda.
ARCO Solar Europe, Inc.
ARCO Solar Europe S.p.A.
ARCO Solar Nigeria LTD.
Arcomex, S.A. de C.V.
Arelex, S.A. de C.V.
Arilan S.A. de C.V.
Arpet Petroleum Limited
Atlantic Richfield de Mexico, S.A. de C.V.
Atlantic Richfield Oil Limited
Aughinish Alumina, Ltd.
Aughinish Estates
Aughinish Finance, Ltd.
Aughinish Property, Ltd.

Badger Pipeline Company
Bear Valley Land Company
Bingham Development Company
Black Lake Pipe Line Company
Blair Athol Coal Pty. Ltd.
Caribou—Chaleur Bay Mines Ltd.
Caribou—Smith Mines Ltd.
Centroamericana de Cobre, S.A.
Chile Copper Company
Cia Inmobiliaria Ispal, S.A.
Clean Bay
Cobre de Hercules, S.A.
Cobrecel, S.A. de C.V.
Cobre de Mexico, S.A.
Codec, S.A. de C.V.
Colonial Pipeline Company
Communication Specialties, Inc.
Compania de Petroleo Ganso Azul, Ltda.
Compania Internacional Minera, S.A. de C.V.
Compania Minera de Cananea, S.A.
Compania Minera Don Richardo, S.A. de C.V.
Compania Minera Dos Republicas, S.A. de C.V.
Compania Minera Penacobre, S.A.
Conalum, S.A.
Conducem, S.A.
Conductores Electricos de Centroamerica, S.A.
Conductores Electricos Peruanos, S.A.
Conductores Guadalajara, S.A.
Condumex, S.A.
Condutel, S.A. de C.V.
Cook Inlet Pipe Line Company
Cupro San Luis, S.A. de C.V.
Datasaab Systems, Inc.
Defender Mining and Milling Corp.
Delaware Bay & River Cooperative
Delaware Bay Transportation Company
Dexter de Mexico, S.A.
Diseno y Construcciones de Maquinaria, S.A.
Dixie Pipeline Company
Dragon Consolidated Mining Company

East Texas Salt Water Disposal Company
85819 Canada Limited
Eisenhower Mining Company
Empaquetadora de Desperdicios, S.A.
Empresas de Comercio Exterior Mexicana, S.A. de C.V.
Empresas Mexicanas de Comercio Exterior, S.A.
Estrategia en Mercadotecnia
Face, S.A. de C.V.
FACOMMEC
Fios E. Cabos Plasticos do Brasil S.A.
FIP, S.A. de C.V.
Flower Street Limited
F.T.L. Company Limited
Gas de Chile, S.A.
Gravity Adjustment, Inc.
Greater Pacific Limited
Greene Cananea Copper Company
Grupo Condumex, S.A.
Hardy Oil Company
Hydrokem Performance Chemicals Company
Hysol Indael de Mexico, S.A.
Imperial Eastman de Mexico, S.A.
Impulsora de Cobre, S.A. de C.V.
Indael, S.A. de C.V.
Industrial de Valvulas, S.A. de C.V.
Industrias Nacobre, S.A. de C.V.
Industrias Tecnos, S.A.
IEQ Argentina
Intelmex, S.A.
Iricon Agency Ltd.
Jamaica Alumina Security Company, Ltd.
Kenai Pipe Line Company
Kronos, Computacion y Teleproceso, S.A.
L. M. Ericsson Holdings, Inc.
Las Quintas Serenas Water Company
LATINCASA
Lavan Petroleum Company
Lingobronce, S.A.
LMC-Canada
Lugatom, S.A.

Macopel, S.A. de C.V.
Magnaval, S.A. de C.V.
Manufacturera Mexicana de Partes de Automoviles
Mayflower Mining Company
Middle Swansea Mining Company
R.W. Miller (Holdings) Limited
Minera Anaconda Limited
Montoro, Empresa Para La Industria Quimica, S.A.
Murfin 1980 Joint Venture
Nacional de Cobre S.A.
New Bingham Mary Mining Company
Nihon Oxiran Company Ltd.
North Lily Mining Company
Oil Shippers Service, Inc.
P.T. Arutmin Indonesia
Pan Americana de Valvulas, S.A. de C.V.
Park City Ventures
Park Cummings Mining Company
Park Premier Mining Company
Participaciones Mexicanas, S.A. de C.V.
Patten Mining Company
Plasticos Primsa, S.A.
Platte Pipe Line Company
Prince Consolidated Mining Company
Productos Especiales Metalicos, S.A.
Promociones Industriales Mexicanas, S.A.
Richfield U.K. Petroleum, Ltd.
Salmat, S.A. de C.V.
Seaside Properties
Servicios Condumex, S.A. de C.V.
Servicios Industriales Nacobre, S.A.
Sinclair (U.K.) Oil Company Limited
Sinclair Venezuelan Oil Company
Smoke House Copper Mining Company
Sociedad Anonima Marvin
Solvamex, S.A. de C.V.
Swecomex, S.A.
Tecumseh Pipe Line Company
Tenemex, S.A.

Terminales Electricas, S.A. de C.V.
Texas-New Mexico Pipe Line Company
Trans Mountain Oil Pipe Line Company
Tuconol, Ltd.
Tubos Colombianos Limitada
Tubos Flexibles, A.A.
Union de Credito Industrial Vallejo, S.A.
United Park City Mines Company
The Walworth Company
West Mayflower Mining Company
William Pryme de Mexico, S.A.

APPENDIX B

COURT OF APPEAL
STATE OF CALIFORNIA
State Building, San Francisco 94102

Winslow Christian
Justice

April 7, 1982

West Publishing Company
Editorial Department
Post Office Box 3526
St. Paul, Minnesota 55165

Re: *Anaconda Co.* v. *Franchise Tax Bd.*
1/Civil 48666

Gentlemen:

In the first sentence of this opinion, filed March 24, 1982, please delete "income years of 1955, 1956, 1957 and 1958" and substitute "income years of 1955 through 1969, inclusive."

Very truly yours,

Secretary to
Justice Christian

cc: Reporter of Decisions

Office of the Attorney General
Edward P. Hollingshead, Esq.
Charles C. Kobayashi, Esq.

Thelen, Marrin, Johnson & Bridges
2 Embarcadero Center
San Francisco 94111

IN THE COURT OF APPEAL
OF THE
STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT, DIVISION FOUR

THE ANACONDA COMPANY a corporation, *Plaintiff and Respondent,* vs. THE FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Defendant and Appellant.*	**1/Civ. 48666** **(Superior Ct. No. 696-859)**

The Franchise Tax Board appeals from a judgment awarding to respondent Anaconda Company refund of $3,423,349.32 taxes paid under the Bank and Corporations Tax Law for income years of 1955, 1956, 1957 and 1958. The court also awarded interest on the disputed amount. The question on appeal is whether, under undisputed facts, the trial court acted correctly when it determined that Anaconda was not engaged in a unitary business with its Chilean and Mexican subsidiaries.

The case was decided on stipulated facts supplemented by oral and documentary evidence received at trial. During the years in question, Anaconda was a Montana corporation engaged in the production of copper and other basic materials. Its corporate headquarters and principal place of business were located in New York City. Anaconda conducted business in California and throughout the United States. The pertinent subsidiaries of Anaconda had the following status:

1. Anaconda Aluminum Company, a wholly owned subsidiary of Anaconda, produced and sold aluminum products in the United States. Anaconda Aluminum was a Montana corporation with its principal place of business in Louisville, Kentucky; its United States facilities included two sales offices in California.

2. Anaconda American Brass Company, a wholly owned Anaconda subsidiary, manufactured brass products.

American Brass was a Connecticut corporation with its principal place of business in Waterbury, Connecticut; it did business throughout the United States including California.

3. Anaconda Wire and Cable Company, a wholly owned subsidiary of Anaconda after 1963, manufactured products derived from copper. Wire and Cable was a Delaware corporation with its principal place of business in New York City and with sales offices and manufacturing plants in California.

4. Anaconda Electronics Company (Anaconda Electronics), a wholly owned subsidiary of Wire and Cable, was primarily in the business of producing community television equipment. Anaconda Electronics was a Delaware corporation with its principal offices in California.

5. Anaconda Sales Company (Anaconda Sales) was a wholly owned Delaware corporation with its principal place of business in New York; it did no business in California. Anaconda Sales marketed the products of the Chilean companies on a commission basis. Anaconda Sales provided complete sales services and developed new markets for the Latin American companies.

6. International Smelting and Refining Company (ISARCO) was a wholly owned Montana corporation operating a major industrial facility and plant in New Jersey; it did no business in California. ISARCO processed a significant proportion of the Chilean production during the years at issue.

7. Anaconda's Chilean and Mexican operating companies, Andes Copper Mining Company (Andes), Chile Exploration Company (Chilex), Santiago Mining and Cananea Consolidated Copper Company, S.A. (Cananea), along with certain domestic affiliates of Anaconda, did no business in California and thus were not California taxpayers.

8. Chilex was a New Jersey corporation wholly owned by Chile Copper, a 99 percent owned Delaware corporation. Chilex had mineral properties, processing facilities, and offices in the Republic of Chile, and an administrative office in New York City.

9. Andes was a Delaware corporation with 99 percent ownership by Anaconda. Andes had mineral properties, processing facilities, administrative and business offices in Chile.

10. Santiago Mining Company was a Delaware corporation wholly owned by Anaconda with mineral properties located in Chile. Santiago is not of major significance in this action.

11. Cananea was a Mexican corporation wholly owned by Greene Cananea, a 99 percent owned Minnesota corporation. Cananea had mineral properties, processing facilities, and offices in Mexico.

Anaconda conceded for the purpose of its claim for tax refund that its domestic group constituted a unitary business. The parties recognize that Anaconda's smaller Chilean company, Santiago Mining, should be treated in the same manner as the two larger Chilean companies, Andes and Chilex.

Anaconda, as the nation's second largest copper producer, was principally engaged in producing copper within the continental United States. Anaconda owned and operated two major copper mines in the United States. The refined copper sold by Anaconda was identical to that sold by Anaconda's competitors. Anaconda's primary contact with California consisted of copper and other mineral sales to California purchasers, involving products mined and processed elsewhere. The company had no administrative or executive offices in this state and was present only as the result of its ownership of several small mines which produced materials other than copper. American Brass and Wire and Cable operated fabricating plants in California and had warehouses and sales distribution centers to serve the California market for manufactured copper products. The raw materials necessary for these California plants were

normally supplied either from Anaconda production or purchases from independent copper producers. These California fabricators did not import foreign materials and did not normally obtain refined copper from any foreign source. Anaconda's California operations were only a small part of Anaconda's business.

Anaconda's three affiliates doing business in Chile (Andes, Chilex, and Santiago Mining) were engaged in mining and processing copper and metal byproducts. Andes and Chilex, along with Braden Copper Corporation, a subsidiary of Kennecott Copper Corporation, were the three major Chilean producers of copper. The copper industry was a major source of export earnings for Chile during the relevant time period.

The Chilean subsidiaries maintained offices in Santiago, Chile; accounting, purchasing, legal services, government liaison, personnel processing, local sales and public relations were functions performed in Santiago. Mining and all business operations were controlled by a general manager who ordinarily came from the United States. The Chilean companies refined some of their copper at an ISARCO facility in New Jersey.

Cananea, Anaconda's Mexican mining company, operated separately from the Chilean companies. Cananea maintained offices in Mexico City and conducted extraction and processing operations at its Mexican mine. Nearly all refining was performed by an independent Mexican corporation.

None of the Latin American companies explored or sold within the United States. Chilex maintained an administrative office in Anaconda's corporate headquarters; the office included an accounting and financial staff serving Chilex and Andes. The New York Chilex office also recruited personnel for assignment to Chile or Mexico. Numerous officers of the Latin American companies were based in New York, and the boards of the Chilean companies met in New York.

Many members of Anaconda's board and executive committee were also members of the boards of the Latin American companies, ISARCO and Anaconda Sales. Some of these persons served simultaneously as officers of Anaconda, the

Latin American companies and other Anaconda subsidiaries. Officers of the Latin American companies often participated at executive committee meetings and submitted reports pertaining to Latin American operations. The Anaconda executive committee was informed of major developments and problems involving the Latin American companies. An informal operating committee composed of certain officers and operating personnel of the Latin American companies was based in New York. There was an overlap of personnel between Anaconda's executive committee and the operating committee, and a representative of the operating committee often met with Anaconda's executive committee. The boards of directors of Anaconda and its Chilean subsidiaries all met in Anaconda's New York headquarters. Cananea's board met in Mexico.

Many Anaconda officers had been employed at one time or another by Latin American companies, but Anaconda had no systematic policy of transfer among its affiliates. Anaconda's personnel department recruited employees for Chilex' New York offices. Personnel decisions pertaining to senior officers of Anaconda and its Latin American companies were subject to approval by Anaconda's executive committee; other personnel decisions were made by the individual companies. Employees of the Latin American companies who were hired in the United States enjoyed the same insurance and retirement plans as Anaconda employees. Certain key Latin American employees participated in the stock option program open to key employees of Anaconda. Latin American companies provided their own health care programs and retirement benefits for employees not otherwise covered. Transferee officers or employees normally retained accrued benefits.

Anaconda performed, at cost, purchasing and other administrative services in the United States and in Europe for the benefit of its subsidiaries. New York approval was required for all appropriations requesting machinery, equipment, tools and parts for the Latin American subsidiaries. Anaconda provided geological engineering services for the Latin American companies.

Anaconda participated in financial planning for the Latin American companies, including decisions as to when to issue additional stock. Anaconda made substantial loans to the Chilean companies and guaranteed several loans for the Latin American companies. All loans were repaid by the Latin American companies. The secretary-treasurer of the Latin American companies in New York, who was also usually the secretary-treasurer of Anaconda, supervised the investment of inactive funds and handled short term security investments for Anaconda and the Latin American companies. The Latin American companies maintained their own accounting departments. However, Anaconda's controller performed functions for Latin American companies as well as for Anaconda. Anaconda periodically audited the Latin American companies.

The Chilean companies sold their production in diverse markets including Western Europe, Latin America and the United States. Copper prices were relatively stable until 1966. The Chilean companies sold most of their production to industrial users in Western Europe, but some of the Chilean product was sold to affiliated customers, American Brass and Wire and Cable, at the prevailing U.S. price for Chilean copper. Cananea sold nearly all of its production locally. No sales of any Latin American copper were made for delivery to California, and no sales activity was conducted in California for the benefit of any Latin American companies.

Chilean law from February 1952 to May 1955 authorized the Central Bank of Chile to purchase the entire output of the major producers at the prevailing U.S. price. The companies were required to continue production and resell the production for the highest possible price with the profit accruing to the benefit of the Central Bank. The foreign-controlled Chilean copper industry also was subjected to heavy taxation and to currency exchange controls.

In 1955, the Chilean government altered the tax base of the major producers. Sales were subjected to the control of the Copper Department, an agency of the government of Chile. The Copper Department was vested with broad powers to promote the production and industrialization of copper in Chile. The Copper Department was financed by exactions upon

the gross revenues of the major producers. The Copper Department required the producers to sell copper to national industries at a discount and make copper available for Chilean manufacture. In 1964, the threat of greater governmental intervention in the copper business led to an agreement between the Chilean subsidiaries and the government requiring Chilex and Andes to make substantial local investments and to increase their refining capacity. The 1964 agreement called for the Chilean corporations to expand their operations and provided for the creation of mining companies of mixed ownership.

In 1966, Andes and Chilex entered into a "Memorandum of Understanding" with the Chilean government providing for certain participation by the government in the proceeds of the companies' sale of copper. This arrangement resulted in a reduction of approximately 23 million dollars in the companies' sales receipts over the 6-month period of the agreement. Andes and Chilex also were required to participate in a program of "compulsory loans" to the Chilean government introduced by the Chilean Readjustment Laws of 1968 and 1969. Andes and Chilex paid approximately 26 million dollars in interest-free "loans" in 1968 and 1969. Finally, in 1971, the operations of the major foreign producers were expropriated.

Concurrently, the United States government was putting pressure on its domestic copper industry to roll back prices. The United States government embargoed for defense purposes exports of scrap copper. The government also required copper producers to reserve a certain proportion of their production for orders related to national defense and to make reports to the Department of Commerce.

Cananea held its mining properties under concessions from the Mexican government. Cananea paid royalties in the form or production taxes. Cananea sold nearly all of its production locally at a price determined under Mexican law. Most of Cananea's supply requirements were subject to import controls; these controls forced Cananea to purchase locally despite higher prices and lower quality. In 1961, the Mexican government called for Mexicanization of the mining industry. Cananea was Mexicanized in 1971.

The trial court concluded that "the mutuality relationship of dependency or contribution required for a single unitary business under California Revenue and Taxation Code section 25101 was not present during the years at issue as between Anaconda's Latin American companies . . . and the Anaconda domestic group of companies doing business in the United States." The trial court further determined that "the unities of use and operation required for a single unitary business under Revenue and Taxation Code section 25101 were not present as between the Latin American companies . . . and the domestic group. [¶] Moreover, irrespective of any other aspects of the relationship between the Latin American companies and the Anaconda domestic group in the United States, unity of ownership and control did not exist between the Latin American companies and the domestic group due to the continuous and pervasive intervention of the respective host country governments of Chile and Mexico."

Appellant contends that respondent's California and out-of-state operations comprise a unitary enterprise subject to the California formula for income apportionment. Extensive testimony and voluminous documentary exhibits were received in evidence, but the essential facts of the case are undisputed. Since the issues here involve the application of taxing statutes to uncontradicted facts, this court is confronted purely with a question of law and is not bound by the findings of the trial court. (*Container Corp. of America v. Franchise Tax Bd.* (1981) 117 Cal.App.3d 988, 993; *Automatic Canteen Co. v. State Board of Equalization* (1965) 238 Cal.App.2d 372, 381.)

The basic principles applicable to this case were reviewed in this court's opinion in *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988. A corporate taxpayer's income must be subjected to apportionment[1] when it "is

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[Fn. 1, cont.] [sic]

[1] The California method of apportionment is explained in Keesling and Warren, *The Unitary Concept in the Allocation of Income* (1960) 12 Hastings L.J. 42, 43: "Under the formula method the business activities within the state are considered to be an inseparable part of a business carried on both within and without the state. The total gross income from the entire business is determined. The allowable deductions are then subtracted and the remaining net income is apportioned within and without the state by means of an allocation formula consisting of various factors which are thought to be relevant in the production of income, such as property, payroll, and sales."

derived from or attributable to sources both within and without the state. . . ." (Rev. & Tax Code, §25101; *Honolulu Oil Corp. v. Franchise Tax Bd.* (1963) 60 Cal.2d 417, 425; *Superior Oil Co. v. Franchise Tax Bd.* (1963) 60 Cal.2d 406, 417; *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 994) "The fairness of allocating to California a just proportion of the profits earned from a unitary business[2] is settled." (*Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 994; see *Butler Bros. v. McColgan* (1942) 315 U.S. 501, 509; *El Dorado Oil Works v. McColgan* (1950) 34 Cal.2d 731, 738, app. dism., 340 U.S. 801; *Edison California Stores v. McColgan* (1947) 30 Cal.2d 472, 478; *Butler Bros. v. McColgan* (1941) 17 Cal.2d 664, 667-678, aff'd in 315 U.S. 501; *Handlery v. Franchise Tax Board, supra,* 26 Cal.App.3d 970, 974.)

The propriety of applying the unitary concept in taxing foreign corporations was established in *Butler Bros. v. McColgan, supra,* 17 Cal.2d 664. The court there noted that only in circumstances where the corporation's California business in "truly separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately, that the separate accounting method

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[2] Keesling and Warren also discuss the unitary treatment of multi-corporate enterprises (*op. cit. supra,* 12 Hastings Law Journal 42, 57): "In any case where a business would be considered unitary if conducted by one taxpayer, it should likewise be so considered even though conducted by two or more affiliated corporations. Just as a state may look beyond its borders and take into account the entire income of a business in arriving at a determination of the amount of income reasonably attributable to the activities conducted within the state, so in the case of a group of affiliated corporations engaged in the conduct of a business, it may look at the total income of the group to determine the amount of income attributable to the portion of the business conducted within the state by one or more of the members of the group."

The fairness of the formula apportionment method is explained as follows: "[T]he 'formula' apportionment of unitary business income has not only been found to be constitutionally permissible, but . . . it is often the only reasonable and practical manner in which a state may levy and collect taxes to which it is constitutionally entitled. It might be described as a sort of rule of necessity, having its origin in the accommodation of a state's constitutional right to tax income derived from within the state, to constitutional due process of law and interstate commerce provisions." (*Handlery v. Franchise Tax Board* (1972) 26 Cal.App.3d 970, 974, app. dism., 410 U.S. 921).

may properly be used." (*Id.*, at pp. 667-668.) The court set out a three-part test to determine the unitary nature of a taxpayer's business: "(1) unity of ownership; (2) unity of operation as evidenced by central purchasing, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation." (*Id.*, at p. 678, quoted in *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 995; see *Honolulu Oil Corp. v. Franchise Tax Bd., supra,* 60 Cal.2d 417, 423; *Superior Oil Co. v. Franchise Tax Bd., supra,* 60 Cal.2d 406, 412; *John Deere Plow Co. v. Franchise Tax Bd.* (1951) 38 Cal.2d 214, 229, app. dism., 343 U.S. 939; *Edison California Stores v. McColgan, supra,* 30 Cal.2d 472, 478; *Chase Brass & Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496, 502, app. dism. 434 U.S. 1029; *Standard Register Co. v. Franchise Tax Board* (1968) 259 Cal.App.2d 125, 129.)

Respondent challenges the first element, unity of ownership. Although the parent corporation owned the foreign subsidiaries, respondent argues that pervasive intervention in the subsidairies' operations by the foreign governments undermined the parent corporation's nominal ownership and control. Unquestionably the host governments regulated and intervened in the subsidiaries' activities. Nevertheless, the parent corporation owned virtually 100 percent of the Latin American subsidiaries. Governmental regulations, which restrict the exercise of some familiar attributes of ownership, do not establish that there was no unity of ownership. Up until the time of expropriation unity existed with respect to some substantial attributes of ownership, i.e., the right to exclude other private entities from intruding upon the owned properties. A second element, unity of operation, depends on diverse factors. No one element controls the decision. (*Container Corp. of America v. Franchise Tax Bd., supra* 117 Cal.App.3d 988, 995.) Intercompany copper sales between the Chilean companies and Anaconda's domestic unitary operation is one factor demonstrating operational unity. (See *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 995; *Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal.App.3d 496, 502, cert. den. 400 U.S. 961.) Appellant

assisted its foreign subsidiaries in its purchasing requirements. Purchasing ties between parent and subsidiary are of some relevance. (*Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 995; *Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal. App.3d 496, 503.)

Although the Latin American companies maintain their own accounting departments, Anaconda made periodic internal audits of Latin American company records. Anaconda also provided statistical material for the Latin American companies. This overlap in auditing is a further factor pointing toward operational unity. (See *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 996.)

Anaconda made several substantial inter-company loans to the Chilean subsidiaries and guaranteed several loans obtained by the foreign subsidiaries. A common secretary-treasurer handled the Chilean subsidiaries' banking transactions in the United States, as well as short term and excess fund investments. These loans serve as "substantial evidence of unity of operation." (*Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal.App.3d 496, 503, quoted in *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 996.)

Employees of respondent who transferred to the foreign subsidiaries were allowed to continue their employee benefits. (See *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 996-997.) Decisions regarding high level personnel were subject to approval by Anaconda's executive committee. Employees of the foreign subsidiaries who were hired in the United States enjoyed the same disability and retirement benefits as Anaconda employees. Furthermore, some employees of the subsidiaries participated in a stock option plan which covered key Anaconda employees.

Anaconda provided engineering and geological services for the foreign subsidiaries. Anaconda provided important administrative services for its foreign subsidiaries which is a relevant factor in determining unity of operation. (See *Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal.App.3d 496,

503.) Anaconda served as a source of legal planning and public relations information. The indications of unity of operation were thus overwhelming.

The third element, unity of use, relates to executive forces and operational systems. (*Superior Oil Co. v. Franchise Tax Bd., supra,* 60 Cal.2d 406, 415; *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 997; *Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal.App.3d 496, 504.) "The integration of major executive functions is a factor of great importance pointing toward unity." (*Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal. App.3d 988, 998; see *Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal.App.3d 496, 504.) There was significant overlap between Anaconda's board of directors and executive committee and the board of directors of the foreign subsidiaries. Many Anaconda officers also were key officers of the foreign subsidiaries. Board meetings were generally held at Anaconda headquarters. The Anaconda board of directors were advised of Latin American operating conditions. Major policy matters were subject to review by Anaconda. (See *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988,998; *Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal. App.3d 496, 504.) Furthermore, financial reports were submitted from the subsidiary to the parent corporation; this is to be accorded some significance. (*Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal. App.3d 988, 998; *Standard Register Co. v. Franchise Tax Board, supra,* 259 Cal. App.2d 125, 136.) It is apparent from the significant overlap of personnel that control on the highest level was exerted by respondent. (*See Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 998.)

The requisite unities exist here. The combination of all the factors and ties between the parent and the subsidiaries support respondent board's determination that the operation is unitary. Appellant engaged in the same general business activities as its subsidiaries. The administrative regulations indicate that a strong inference of a unitary business exists where the taxpayer

is engaged in the same type of business.[3] (*See Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988; 1000.) This administrative construction of the California tax laws "is entitled to great weight, and courts generally will not depart from such construction unless it is clearly erroneous or unauthorized." (*Coca-Cola Co. v. State Bd. of Equalization* (1945) 25 Cal.2d 918, 921; also see *Select Base Materials v. Board of Equal.* (1959) 51 Cal.2d 640, 647; *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 1000; *Albright v. State of California* (1979) 101 Cal.App.3d 14, 18; *Cal. Correctional Officers' Assn. v. Board of Administration* (1978) 76 Cal.App.3d 786, 793-794; *Clayton v. County of Los Angeles* (1972) 26 Cal.App.3d 390, 396.)

Respondent's California business was dependent upon or contributed to the operation of its business outside the state. (*Superior Oil Co. v. Franchise Tax Bd., supra,* 60 Cal.2d 406, 412; *Edison California Stores v. McColgan, supra,* 30 Cal.2d 472, 481; *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App. 3d 988, 1001; *Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal.App.3d 496, 501.)

Respondent relies on *Chase Brass & Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496, to support the trial court's determination. In *Chase,* the court considered, among other issues, whether Braden, a copper producer, and Chase, a manufacturer, were unitary; both were subsidiaries of the same parent company, Kennecott Copper Corporation. In its discussion of the unitary principle, the court noted that the

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[3] California Administrative Code, title 18, section 25120, subdivision (b), provides in part: "The determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or business will turn on the facts of each case. In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the divisions under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be good indicia of a single trade or business; and the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade or business:

"(1) *Same type of business:* A taxpayer is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a taxpayer which operates a chain of retail grocery stores will almost always be engaged in a single trade or business."

functions of a vertically integrated enterprise are "not so markedly unitary as they are in a horizontally integrated business." (*Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal.App.3d 496, 502.) In that Braden and Chase were involved in different aspects of the copper business, they would be considered vertical and thus less likely to be unitary. Ultimately, the court held that "[e]xcept for the matter of sales and joint ownership, Braden and Chase are not unitary. We support the conclusion of the trial court to this extent." (*Chase Brass & Copper Co. v. Franchise Tax Bd., supra,* 10 Cal.App.3d 496, 506.)

The situation here is distinguishable in that, first, both Anaconda and the Latin American subsidiaries were involved in the mining aspect of the copper business. Thus, unlike *Chase Brass,* the taxpayer and the subsidiary in question here are in a horizontal rather than a vertical relationship. Moreover, the extensive factual background of this case also supports the conclusion that the businesses are unitary. In addition to the factors of joint sales and ownership mentioned in *Chase,* here there was evidence, absent in *Chase,* of extensive operational ties in areas such as purchasing, personnel, accounting, loans and engineering services. There was also uncontradicted evidence of integration of major executive functions such as overlap on the boards of directors and in the key officer positions of the companies.

Respondent's foreign subsidiaries are subject to inclusion in the apportionment base. Respondent's constitutional objections to this taxing formula were amply discussed and dismissed in *Container Corp. of America v. Franchise Tax Bd.* (1981) 117 Cal.App.3d 988, 1003-1007; that analysis need not be repeated here.

Respondent asserts that critical issues were not reached by the trial court and a remand is therefore required. Specifically, the trial court deemed it unnecessary to determine:

> "(a) Whether the Franchise Tax Board's standard three-factor formula was the proper one for apportioning unitary business income to California under assessments which included the Latin American companies within the California unitary group.

"(b) Whether the Franchise Tax Board's assessments correctly stated net unitary business income on the basis of a California unitary group which included the Latin American companies."

Essentially Anaconda claims that the formula, as applied, was arbitrary and unreasonable in that, first, it failed to take into account the differences in production values between the United States and Latin America, and second, to allow proper adjustments to the income of the Latin American companies on account of the ongoing interventions of the host governments of Chile and Mexico.

The underlying factual matters were covered by the trial court's findings based on the stipulation and the supplementary evidence. The determinative facts include: that the 3-factor formula was utilized to apportion the income; that the formula was not adjusted for variance in Latin American productivity; and that "in keeping with its normal treatment of multinational corporate groups, the Franchise Tax Board made no adjustments whatsoever for any corporate income or production taxes paid by Latin American companies to Chile or Mexico." Because these pertinent facts have been determined without dispute, this court may make its own determinations of the questions of law presented by respondent as to the appropriateness of the formula utilized. (*Container Corp. of America* v. *Franchise Tax Bd.* (1981) 117 Cal.App.3d 988, 993.)

Appellant Franchise Tax Board normally employs a three-factor property-payroll-sales formula to apportion unitary business income to California.[4] "[T]he Board's discretion to use the three-factor formula has been upheld by an unbroken series

[4] The formula is applied in the following manner: "The percentage of the firm's total real property and tangible personal property in California is computed; the percentage of the firm's total payroll of wages, salaries and commissions paid to employees in California is computed; the percentage of the firm's gross sales, less returns and allowances, in California is computed. The three percentage figures are totaled and the resulting sum is then divided by three. The final figure applied to total business income represents the percentage of the total net business income of a firm which can be allocated to California." (*Chase Brass & Copper* v. *Franchise Tax Bd., supra,* 70 Cal.App.3d 457, 467, fn. 12; see Wahrhaftig, Allocation Factors in Use in California, 12 Hastings L.J. 65.)

of California decisions." (*Chase Brass & Copper Co.* v. *Franchise Tax Bd.* (1977) 70 Cal.App.3d 457, 467 [Chase II]; *John Deere Plow Co.* v. *Franchise Tax Bd.* (1951) 38 Cal.2d 214, 222; *El Dorado Oil Works* v. *McColgan* (1950) 34 Cal.2d 731, 738, *app. dism.*, 340 U.S. 801; *Edison California Stores* v. *McColgan* (1947) 30 Cal.2d 472, 479.)

Respondent concedes that the intrinsic fairness of the formula is settled, but challenges the formula as applied in the circumstances of its particular unitary business.

" 'The Franchise Tax Board is given discretion in the selection of [the] factors to be utilized in a tax formula [citation] and where, as here, the taxpayer contends that the formula is arbitrary and reaches an unreasonable result, the burden is on the taxpayer to establish such facts by clear and convincing evidence.' (See *Butler Bros. v. McColgan, supra,* 315 U.S. 501, 507[ ].)" (*McDonnell Douglas Corp. v. Franchise Tax Board* (1968) 69 Cal.2d 506, 512.)

In light of the "practical administrative difficulties that necessarily arise in fixing upon a workable formula for general application" (*El Dorado Oil Works. v. McColgan, supra,* 34 Cal.2d 731, 738), the only requirement to be met is that "the formula used be not intrinsically arbitrary or produce an unreasonable result. . . . In the apportionment of a unitary business the formula used must give adequate weight to the essential elements responsible for the earning of the income . . . but its propriety in a given case does not require that the factors appropriately employed be equally productive in the taxing state as they are for the business as a whole. Varying conditions in the different states wherein the integrated parts of the whole business function must be expected to cause individual deviation from the national average of the factors in the formula equation, and yet the mutual dependency of the interrelated activities in furtherance of the entire business sustains the apportionment process." (*John Deere Plow Co. v. Franchise Tax Bd., supra,* 38 Cal. 2d 214, 224-225.)

Respondent first claims that the formula as applied produced an unreasonable result in that it failed to give recognition to the "vast differences in production values and business

conditions as between the United States and Latin America. . . . [T]his disparity results in an apportionment of income to the State far in excess of any amount reasonably attributable to Anaconda's California operations."

An identical assertion was rejected by this court in *Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 1003-1004, where the taxpayer contended that "the application of the apportionment formula to foreign subsidiaries fails to account for different wages, property costs and returns on sales." (*Id.,* at p. 1003.) Variations in profitability *within* the United States have not precluded apportionment of income according to an appropriate formula; similarly, where the variations occur between domestic and foreign subsidiaries, an appropriate formula may still be applied. (*Id.;* see also *John Deere Plow Co. v. Franchise Tax Bd., supra,* 38 Cal.2d 214, 224-225.)

Respondent points out that the exhibits to the stipulation of facts indicate that there is a marked difference in the factors of payroll, property and sales, as a function of productivity, between its Latin American and domestic operations. Such variations also exist within the United States and have not been held to preclude unitary treatment. (*Container Corp. of America v. Franchise Tax Bd., supra,* 117 Cal.App.3d 988, 1003.) No showing has been made which would justify an exception to unitary treatment for respondent's Latin American operations. In short, respondent's evidence does not meet the burden of showing by "clear and cogent evidence that [the formula] results in extraterritorial values being taxed." (*Butler Bros. v. McColgan, supra,* 315 U.S. 501, 507; *N & W Ry. Co. v. No. Carolina* (1936) 297 U.S. 682, 688.)

Respondent next claims that the formula was improper as applied in that no adjustments were made for the costs imposed on it by the governments of Chile and Mexico. Respondent emphasizes the failure of the formula to take account of the income taxes paid by it to the governments of Chile and Mexico. It argues that, although labeled as "income taxes," the taxes were in effect "royalty" or "participation" payment taxes and thereby deductible.

"Taxes on or according to or measured by income or profits . . . imposed by the authority of . . . any foreign country" are explicitly made nondeductible by statute. (Rev. & Tax. Code, §24345, subd. (a)(2).) The taxes imposed on Anaconda by the Mexican and Chilean governments fall within this statutory mandate. Furthermore, "exemptions from taxation must be found in the statute" (*Market St. Ry. Co. v. Cal. St. Bd. Equal.* (1955) 137 Cal.App.2d 87, 96); and statutes granting exemptions from taxation must be reasonably, but nevertheless strictly construed against the taxpayer (*Standard Oil Co. v. State Bd. of Equalization* (1974) 39 Cal.App.3d 765, 769). The taxpayer has the burden of showing that he clearly comes within the exception and any doubts must be resolved against the right to an exemption. (*Id.*) Respondent has failed to meet this burden; its arguments must therefore be rejected.

In conclusion, the statistical evidence presented by respondent fails to show that the application of the apportionment formula to its unitary operations yields a distorted result. Furthermore, respondent fails to account for the contributions to income which result from the functional integration and centralization of management which exist in a unitary operation. "The very notion of a unitary business implies that the taxpayer's affairs within and outside the taxing jurisdiction are so indivisible that income from property and activities within the jurisdiction cannot be measured without taking into account income from property and activities located elsewhere." (*Luckenbach S.S. Co. v. Franchise Tax Bd.* (1963) 219 Cal.App.2d 710, 719.)

Respondent has failed to meet its burden to make oppression manifest by clear and cogent evidence. (*El Dorado Oil Works v. McColgan, supra,* 34 Cal.2d 731, 744.) Thus, the Franchise Tax Board's allocation formula based on the three-factor tax base—payroll, property and sales—appears, in its application to Anaconda's unitary enterprise, to have been an honest effort to apportion to California that part of its income fairly attributable to business done within the state. "No method of allocation can precisely determine the exact amount of income attributable either to any given geographic area or to any given part of a series of business transactions culminating in

the realization of a profit, and 'any effort' in that regard 'must be more or less arbitrary and fictitious' [citation] as a matter of practical tax administration. In short, as was . . .said by the Supreme Court of the United States in sustaining the validity of a franchise tax assessment, the 'practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities . . . [makes] "rough approximation rather than precision" . . . sufficient' in the formula allocation of income from a unitary business." (*Id.*, at p. 741.)

Under this principle, the formula as applied to respondent's income from its unitary enterprise met the requisite standard; as a result, respondent's challenge must fail.

The judgment is reversed with directions to render judgment for appellant.

Certified for publication.

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Christian, J.

We concur:

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Caldecott, P. J.

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Rattigan, J.

Trial Court: Superior Court, County of San Francisco

Trial Judge: Robert J. Drewes

Attorneys for Appellant:

GEORGE DEUKMEJIAN,
Atty. Gen. of the State of
California

EDWARD P. HOLLINGSHEAD,
Deputy

CHARLES C. KOBAYASHI,
Deputy

555 Capitol Mall, Suite 350
Sacramento, Calif. 94102

Attorneys for Respondent:

PETER ANDERSON
R. TYLER ANDERSEN
FRED A. RODRIGUEZ

THELEN, MARRIN, JOHNSON & BRIDGES
Two Embarcadero Center
San Francisco, CA 94111

The Anaconda Co. v. Franchise Tax Board
1/Civil 48666

APPENDIX C

CALIFORNIA SUPERIOR COURT
CITY AND COUNTY OF SAN FRANCISCO
DEPARTMENT NUMBER FOURTEEN

THE ANACONDA COMPANY, a corporation, on its own behalf and as successor by merger to ANACONDA AMERICAN BRASS COMPANY ANACONDA WIRE AND CABLE COMPANY ANACONDA ALUMINUM COMPANY AND ANACONDA ELECTRONICS COMPANY, *Plaintiff,*	
vs.	No. 696-859
THE FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA *Defendant.*	**FINDINGS OF FACT AND CONCLUSIONS OF LAW**

The above-entitled case came on regularly for trial on August 21, 1978 before the Honorable Robert J. Drewes, Judge of the Superior Court, presiding without a jury. Plaintiff was represented by Thelen, Marrin, Johnson & Bridges, appearing through Peter Anderson and R. Tyler Andersen. Defendant was represented by Evelle J. Younger, Attorney General of the State of California, appearing through Charles C. Kobayashi, Deputy Attorney General. Evidence, both oral and documentary, was introduced on behalf of the parties and the case was argued, briefed and submitted for decision. The Court, having considered all the evidence, as well as the briefs and arguments of counsel, and being fully advised, now makes the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

A. GENERAL

1. The facts stated in the Stipulation of Facts (the "Stipulation") on file herein are true and correct, and the Court hereby adopts said Stipulation as findings of this Court.

2. The testimony of the witnesses offered by plaintiff is uncontradicted, and the Court finds that the facts stated by said witnesses are true and correct.

3. The findings set forth herein are equally applicable to each and every of the calendar years 1955 through 1969, unless otherwise specifically indicated. Said period constitutes the income years at issue in this tax refund action.

B. THE PARTIES

4. During the years at issue, plaintiff, The Anaconda Company ("Anaconda"), was a publicly held Montana corporation with its headquarters and principal place of business located at 25 Broadway in New York City. As a leading domestic producer of copper and other hard minerals, Anaconda conducted business throughout the United States, having mineral properties and mines in the State of California. Anaconda was also the parent company and majority shareholder of approximately fifty other companies, a number of which are involved directly or indirectly in the present action.

5. Anaconda Aluminum Company ("Anaconda Aluminum") was a wholly owned subsidiary of Anaconda engaged in the domestic manufacture and sale of aluminum products. Organized under the laws of the State of Montana, Anaconda Aluminum maintained its principal place of business in Louisville, Kentucky, with a number of other facilities located throughout the country including sales offices in both San Francisco and Los Angeles.

6. Similarly, Anaconda American Brass Company ("American Brass") was a wholly owned Anaconda subsidiary, incorporated under the laws of Connecticut with its principal place of business in Waterbury, Connecticut. Engaged in the

manufacture and fabricating of brass products derived from copper, American Brass did business throughout the United States, including the State of California.

7. Anaconda Wire and Cable Company ("Wire and Cable") was a manufacturer and fabricator of products derived from copper. Wholly owned by Anaconda after 1963, Wire and Cable was a Delaware corporation with its principal place of business in New York City. The company maintained sales offices and manufacturing plants in California, as well as a number of other facilities located throughout the country.

8. Anaconda Electronics Company ("Anaconda Electronics") was a wholly owned subsidiary of Wire and Cable. Organized and existing under the laws of the State of Delaware with its principal offices in California, Anaconda Electronics was engaged primarily in the business of fabricating and selling community television equipment.

9. Defendant, Franchise Tax Board of the State of California (the "Franchise Tax Board") is an agency of the State of California empowered to assess and collect taxes under the California Bank and Corporation Franchise Tax Law.

C. OTHER ENTITIES

10. This action also involves a number of other Anaconda affiliates which were not doing business in California and which are not parties to the lawsuit. Such companies include:

11. Anaconda Sales Company ("Anaconda Sales"), a wholly owned Delaware corporation with its corporate headquarters in New York City;

12. International Smelting and Refining Company ("International Smelting and Refining"), a wholly owned Montana corporation with a plant and major industrial facility located in Perth Amboy, New Jersey and a plant located in Toole, Utah;

13. Chile Copper Company ("Chile Copper"), a 99 percent owned Delaware corporation which in effect served as a holding company for Chile Exploration Company;

14. Chile Exploration Company ("Chilex"), a New Jersey corporation wholly owned by Chile Copper, with mineral properties, processing facilities, administrative offices and business offices all located in the Republic of Chile and an administrative office located in New York City;

15. Andes Copper Mining Company ("Andes"), a Delaware corporation 99 percent owned by Anaconda, also with mineral properties, processing facilities, administrative offices and business offices located in the Republic of Chile;

16. Santiago Mining Company ("Santiago Mining"), a Delaware corporation wholly owned by Anaconda, with mineral properties located near Santiago, Chile;

17. Greene Cananea Copper Company ("Greene Cananea"), a 99 percent owned Minnesota corporation which in effect served as a holding company for Cananea Consolidated Copper Company, S.A.; and

18. Cananea Consolidated Copper Company, S.A. ("Cananea"), a Mexican corporation wholly owned by Greene Cananea, with mineral properties, processing facilities, administrative offices and business offices all located in the Republic of Mexico.

19. While all of the above affiliates of Anaconda are involved directly or indirectly in this action, the principal dispute concerns the Chilean and Mexican operating companies, Andes, Chilex, Santiago Mining and Cananea. For convenience, these four companies alone will sometimes be referred to collectively as the "Latin American companies".

D. NATURE OF THE CONTROVERSY AND JURISDICTION

20. This action involves a number of claims for refund of California franchise taxes and interest paid by Anaconda under protest for the income years 1955-1969. The assessments at issue were made by the Franchise Tax Board on the basis of a unitary business grouping which included not only Anaconda and its domestic affiliates doing business in the United States, but also Anaconda's Latin American companies doing business in Chile and Mexico. Having paid the assessments and filed

timely claims for refund (which were denied by the Franchise Tax Board), Anaconda commenced this action pursuant to California Revenue and Taxation Code Sections 26102 and 26103.

E. THE BUSINESS OF THE ANACONDA DOMESTIC GROUP

21. The nature of the business conducted by the Anaconda domestic group of companies and the operating relationships among these companies are described in detail in section 3 (pages 5-13) of the Stipulation. Summarized briefly, this business consisted principally of a copper mining and processing operation conducted by Anaconda in the United States, together with related processing, manufacturing and sales activities conducted by the other Anaconda domestic affiliates. The key members of this domestic copper group were:

22. Anaconda itself, which owned and operated two major U.S. copper mines located in Montana and Nevada;

23. International Smelting and Refining, which operated a refinery at Perth Amboy, New Jersey;

24. American Brass, which purchased refined copper as a raw material and manufactured it into so-called "brass mill products" such as copper rod, sheet, wire and tube;

25. Wire and Cable, which also purchased refined copper for manufacture into "wire mill products" consisting of copper rod, wire and cable used for electrical transmission purposes; and

26. Anaconda Sales, which acted as the sales representative of several primary metal producers (including Anaconda), marketing production on a commission basis.

27. As discussed in the Stipulation, both American Brass and Wire and Cable purchased large amounts of copper from Anaconda. However, the products manufactured by these two fabricating affiliates were sold almost entirely to unaffiliated end users. Intercompany sales made to the fabricating affiliates

were transacted through Anaconda Sales and involved production refined at the Perth Amboy facility of International Smelting and Refining, as well as production processed elsewhere in the United States by Anaconda itself.

28. With respect to the California portion of Anaconda's business, it is stipulated that Anaconda was not involved in the mining or processing of copper in California but was only present in the State as a result of its ownership of several small mines producing other minerals. The company had no administrative or executive offices in the State, nor did it conduct any other California business relating to copper.

29. American Brass and Wire and Cable, however, both had fabricating plants in the State (principally a brass rolling mill and wire and cable fabricating facilities), as well as warehouses and sales distribution centers established to service the California market for manufactured copper products. The raw metal requirements of these California plants normally were supplied either from Anaconda production refined in Montana or by purchases from independent copper producers. The California fabricators did not import any production from outside the United States, nor did they normally obtain any refined copper from the International Smelting and Refining Facility in New Jersey. Given the closer proximity of the Montana sources, as well as other independent western sellers, the savings in freight costs alone dictated reliance on western suppliers.

30. Two other Anaconda domestic affiliates—Anaconda Aluminum and Anaconda Electronics—were also doing business in California during at least part of the years at issue, but neither was involved directly in the business of copper. The companies are mentioned in this lawsuit solely because they were members of the Anaconda group filing franchise tax returns in California.

F. THE LATIN AMERICAN BUSINESS

(i) The Four Companies

31. During the period at issue, Anaconda also had three affiliates doing business in the Republic of Chile: Andes, Chilex and Santiago Mining. All were engaged in the mining and

processing of copper and metal by-products. Two of these companies, Andes and Chilex, were among the three largest of the Chilean copper producers, the third member of the triumvirate being Braden Copper Corporation ("Braden") owned by Kennecott Copper Corporation ("Kennecott"), also an American company. These three major Chilean producers were known collectively in Chile as the "*Gran Mineria del Cobre*".

32. Until 1959, Andes operated an underground mine called Potrerillos located high in the mountains of central Chile. Obtained in 1916, Potrerillos had been Anaconda's first acquisition in Chile. Along with Braden's El Teniente mine located southeast of the capital city of Santiago, it was one of the world's largest underground copper mines, yielding a yearly output of 89 million pounds of copper in 1955, together with 464,000 ounces of silver and 19,000 ounces of gold. As production at Potrerillos declined in the late 1950's, however, Andes developed a new underground mine called El Salvador located only a few miles distant from Potrerillos. Many of the facilities used at Potrerillos were taken over by the El Salvador mine, and the same overall pattern of operations followed at Potrerillos continued in effect at El Salvador. Accordingly, for purposes of convenience, Andes' mining properties generally will be referred to herein as "El Salvador".

33. In terms of production, the larger and more important operation in Chile was the Chuquicamata mine maintained by Anaconda's other Gran Mineria affiliate, Chilex. Chuquicamata was an immense open pit mine located in the Atacama desert at the foot of the Andes mountain range in Northern Chile. It had been acquired in 1923 by Anaconda from the New York Guggenheim interests and remained a major source of Chilean copper throughout the period at issue in this lawsuit. By way of comparison with Andes, Chilex production from Chuquicamata totalled 461 million pounds of copper in 1955, together with 583,000 ounces of silver and 3,000 ounces of gold. In 1969, the last year at issue herein, Chuquicamata production had increased to 624 million pounds of copper.

34. Anaconda's third Chilean affiliate, Santiago Mining, was a much smaller operation, acquired from local interests in 1917. The company's principal mining property was the La Africana mine located a few miles west of the city of Santiago.

This had been undeveloped for many years prior to the period at issue herein and was not put into operation until 1958. Thereafter, production continued at relatively low levels throughout the 1960's, never approaching the orders of magnitude achieved at El Salvador and Chuquicamata. Santiago Mining was not included in the *Gran Mineria* and is not of major significance in the California franchise tax assessments giving rise to this action.

35. The final Latin American company involved in this action is Anaconda's Mexican mining company, Cananea. Considerably smaller than Andes and Chilex, Cananea operated an open pit copper mine in the northern Mexican state of Sonora. The property was Anaconda's first Latin American acquisition, obtained in 1907 under concessions from the Mexican government. Continuing in production throughout the 1955-1969 period, Cananea yielded a total output in 1955 of 66 million pounds of copper, together with 468,286 ounces of silver and 4,550 ounces of gold. By 1969, yearly copper output had increased to 73 million pounds, approximately the production level of the Andes Potrerillos mine during its declining years in the late 1950's. While Cananea's operations were completely separate from the operations of the Chilean companies, Cananea raises many similar issues for purposes of the California franchise tax.

(ii) Operations in Latin American

36. Throughout the 1955-1969 period, the Chilean companies maintained administrative and business offices in the city of Santiago. A number of corporate employees resided in the city, where a general staff was assembled to service all three of the Chilean mining companies. Among the functions performed in Santiago were accounting, purchasing, legal services, government relations, personnel processing, local sales and public relations. Consisting of both Americans and Chilean nationals, the Santiago group was headed by a Chilean (Rudolfo Michels) during many of the years at issue in this action.

37. While administration in Chile was based in Santiago, the mines themselves constituted the operating centers of the business in Chile. The remote locations of El Salvador and

Chuquicamata in particular necessitated the establishment of entire communities constructed and maintained by the companies. Thus at both mines, towns were built, including hospitals, schools, churches, theaters, recreation facilities and employee housing. Under the direction of a general manager (normally from the United States), a large staff of technicians and operating personnel were based at the mines, together with a second administrative team which handled such on-site matters as labor relations and government regulation. In the early 1960's, the total work force (including labor) at El Salvador was nearly 4,000, while the work force at Chuquicamata numbered in excess of 6,000.

38. In addition to a townsite and mining facility, both Andes and Chilex operated geological research centers at the mines, as well as concentrating and smelting facilities. Thus, during the years at issue, all of the copper production of the companies was processed at the mines through the smelting stage. With respect to refining, a portion of Chilean production was processed locally, primarily in facilities located at the mines and occasionally at a government owned refinery located near Santiago.

39. Cananea in Mexico followed a similar pattern of operations. Local business and administrative offices were maintained in Mexico City under the direction of a Mexican national (Eduardo Prieto), while extraction and processing operations were conducted at the mine. In Mexico, however, nearly all refining was performed by an independent Mexican corporation named Cobre de Mexico. The processing of ore by Cananea ended with the production of blister copper (i.e. unrefined copper), which in turn was sold almost entirely to Cobre de Mexico.

(iii) Operations in the United States

40. During the years at issue, none of the Latin American companies was engaged in mining, processing, selling or exploration activities within the United States. The sole United States presence of any of the companies was an administrative office maintained by Chilex at 25 Broadway in New York City, also the location of Anaconda's corporate headquarters. Subleased

from Anaconda, the space was occupied primarily by an accounting and financial staff which performed controllership, accounting and bookkeeping services for both Chilex and Andes. In addition, the office housed a small personnel department established to recruit and process job applicants for assignment to Chile or Mexico. Finally, a number of officers of the Latin American companies were based in New York and the boards of directors of the Chilean companies met in New York, since the directors by and large were representatives of Anaconda, the principal shareholder.

41. Aside from these contacts, the Latin American companies operated entirely outside the country. They neither owned any commercial property in the United States, nor conducted any mining or sales activity here, nor maintained any other type of industrial facility. It follows that the companies had no presence whatsoever in the State of California.

42. That the Latin American operations were predominately foreign is further indicated by the fact that each of the companies qualified under Section 921 of the U.S. Internal Revenue Code as a Western Hemisphere trade corporation for each of the years at issue. As defined in Section 921, a Western Hemisphere trade corporation is a corporation "all of whose business (other than incidental purchases) is done in any country or countries in North, Central, or South America . . . [provided that] 95 percent or more of the gross income of such . . . corporation for the 3-year period immediately preceding the close of the taxable year . . . was derived from sources without the United States . . ." In meeting this requirement, it was necessary for the Latin American companies to establish that they were engaged in business outside the United States to the extent that 95 percent or more of their gross income for the period 1955-1969 constituted foreign source income.

(iv) Relationships with Anaconda and its Domestic Affiliates

43. The intercorporate relations between the Latin American companies and the Anaconda group in the United States are fully described in sections 4(v) and 4(vi) of the Stipulation. Summarized briefly, there were interlocking directors and

officers as between the Chilean companies and the Anaconda domestic group. Also, Anaconda provided a number of general corporate services for the Latin American companies in New York, including U.S. federal tax accounting, insurance and personnel services, data processing, financial and budgetary services and other administrative services. In addition, Anaconda's New York purchasing department assisted the Latin American companies in the procurement of U.S. goods and services for export to Chile and Mexico, since none of the companies maintained its own purchasing office in the United States. Anaconda performed all of these services from its New York offices, charging the Latin American companies a yearly fee determined on the basis of cost. In terms of the total operating expenditures of the Latin American companies, however, such services were relatively minor, the charge amounting to a yearly average of less than 2 percent of each company's total operating costs.

44. Besides the services provided by Anaconda to the Latin American companies, Anaconda Sales marketed the production of the Chilean companies to the extent of exports from Chile. Anaconda Sales handled the account on a commission basis, normally acting as the sales representative of the companies in the same manner as it handled production from other sources. Anaconda Sales did not market production sold within Chile, however; nor did it market any of the production of Cananea. The copper produced by Cananea normally was sold by that company for its own account entirely within Mexico.

45. Finally, a portion of the copper produced in Chile was sent to International Smelting and Refining's Perth Amboy plant for refining prior to being sold by the Latin American companies to industrial users in Europe or the United States. International Smelting and Refining handled such production on a toll fee basis, just as it handled production from unaffiliated producers. No Chilean production was refined at Anaconda's own refining facilities in Montana, however; nor was any Mexican production normally refined in the United States. Moreover, as local Chilean refining capacity increased during the 1950's and early 1960's, the relationship with International

Smelting and Refining declined in relative terms, such that by the late 1960's the major portion of Chilean production was refined in Chile.

(v) Sales of the Latin American Companies

46. The Chilean companies sold their production in a number of markets, including Western Europe, the Far East, Latin America and the United States. The major market for Chilean copper was the world export market centered in Western Europe.

47. Included in exports to the United States market were sales of the Chilean companies to affiliated customers (namely, American Brass and Wire and Cable). All such transactions between the Chilean companies and Anaconda's domestic affiliates occurred at the prevailing U.S. price for Chilean copper and, like domestic U.S. sales, involved a fungible commodity indistinguishable as to source or producer. In addition to sales to American Brass and Wire and Cable, the Chilean companies also exported copper to unaffiliated customers in the United States.

48. Cananea, on the other hand, sold nearly all of its production locally (to Cobre de Mexico) within Mexico. Moreover, during the period at issue, no sales of either Chilean or Mexican copper were made for delivery to California, nor was any sales activity conducted for or on behalf of any of the Latin American companies in California.

(vi) Government Control In Chile

49. Throughout the years at issue, Anaconda's Chilean companies were extensively regulated and controlled by the Chilean government. Government intervention on a massive scale began in the early 1950's and culminated with the eventual expropriation of the Chilean mining properties by the Allende administration in 1971. This long-term development stemmed in part from the national significance of copper as Chile's most important source of government revenue and foreign exchange earnings. Public control may also be explained in part by the fact that all three of Chile's large copper

producers (i.e. Andes, Chilex and Braden which together constituted the *Gran Mineria*) were foreign owned corporations viewed as outsiders by the Chilean government.

50. In chronological terms, the first major assertion of government control affecting the years at issue occurred in 1952. As a result of the Korean War, world demand for copper had increased, and under wartime price controls the United States government had fixed the price of U.S. domestic copper at 24.5 cents per pound. The price of Chilean copper imported into the United States was similarly fixed, notwithstanding the fact that the world market price was considerably higher. Objecting to exports at the U.S. price, the Chilean government sought to ensure that its copper producers would sell in the European market at the higher rate, regardless of the requirements of the United States.

51. Under Chilean Law 10,255, enacted in February of 1952 and in effect until May of 1955, the Central Bank of Chile was authorized to purchase the entire production of the *Gran Mineria* at the prevailing U.S. price of 24.5 cents per pound. The companies, in turn, were required to continue in production and sell to the Central Bank. The Bank was further authorized to resell the copper either on the Chilean domestic market or the world market at whatever price the Bank could obtain. The entire excess of the resale price over the 24.5 cents purchase price accrued to the benefit of the Central Bank.

52. In effect, the arrangement constituted a 100 percent surtax on the companies' gross revenues in excess of 24.5 cents per pound. By placing all production under the control of the Central Bank, the legislation also created a government sales monopoly which removed from the companies entirely the power to dispose of their own copper. However, since the Central Bank did not possess the expertise to market its purchases, it required the companies to continue selling on the world market for the Bank's account. Thus from 1952 until May of 1955, the sale representatives of the companies marketed, at a higher world price, Chilean copper which the companies had "sold" to the Central Bank at 24.5 cents a pound.

53. During this period, the government also participated in a number of other ways in the earnings of Anaconda's Chilean companies. Over and above the revenues diverted from the companies under Law 10,255, local income taxation claimed up to 75 percent of the companies' "net taxable income" as defined for Chilean tax purposes. In addition, the companies were subject to a special foreign exchange rate whereby they were compelled to pay the government an amount in excess of international market value for their purchases of Chilean currency. Thus, while the American companies paid a fixed rate of 19.37 Chilean pesos per dollar, the free market rate of exchange ran as high as 110 pesos per dollar in 1955.

54. Beginning in May of 1955, however, a new regulatory regime was instituted for the *Gran Mineria* pursuant to Chilean Law 11,828. The centerpiece of this regime was a government agency called the Copper Department (later changed to the Copper Corporation or "Codelco"). Consisting of an independent administrative body with full legal status to conduct business and enter into contracts for its own account, the Copper Department was headed by a governing committee or board of directors which included representatives from the companies themselves. The Law thus provided for an eleven member board, consisting of the Minister of Mining, three representatives of the President of Chile, two directors of the Central Bank, two representatives of the *Gran Mineria*, two labor representatives and one representative of the Board of the National Mining Society. Decisions of the board required a majority vote and were binding on the companies, without right of judicial or administrative appeal. The Law also created a role for the companies in the financing of the Copper Department by providing that its annual budget would be funded by a ¼ percent commission on the gross proceeds of the *Gran Mineria*.

55. As stated in Section II, Article 15 of the 1955 Law, the primary purpose and responsibility of the Copper Department was to "[i]ntervene in the international commerce of copper, with the object of maintaining or extending markets for Chilean copper and preventing or counteracting any action tending

unilaterally to control or restrict its markets". In order to achieve this result, the Department was given a broad range of powers over the companies, including the authority: (a) to regulate all exports of copper by the *Gran Mineria;* (b) to control all imports of equipment and materials; (c) to make direct sales of copper "in representation of the producing companies"; and (d) to direct the sale and disposition of copper within the Chilean domestic market. Also the Law granted the Department extensive regulatory powers over operating conditions at the mines, as well as health and safety matters and other aspects of the companies' primary production.

56. In the years following its establishment, the Copper Department utilized these powers extensively. As it expanded in size and developed a working knowledge of the copper industry, the Department increasingly intervened in both the operations and the policy determinations of the Anaconda companies. In organizational terms, the result was the gradual creation of a governmental body which mirrored almost exactly the structure and functions of the companies themselves. In operational terms, the result was a high degree of direct government participation in nearly every aspect of the Chilean copper business.

57. More specifically, the Copper Department exercised (*inter alia*) the following powers in performance of its statutory responsibilities:

58. All exports of copper from Chile were subject to review and approval by the Department on a shipment by shipment basis, including review of the price and terms and conditions of sale, the geographical market and the ultimate purchaser.

59. The Department made the final determination regarding the price of all Chilean copper, which often differed from the price charged for copper by Anaconda in the United States.

60. The yearly marketing plans of the companies were subject to review and approval by the Department, which frequently resulted in changes and additions being made at the request of the Department.

61. Sales of copper were made independently by the Department on behalf of the companies and Department personnel often accompanied the sales representatives of the companies on foreign marketing assignments.

62. All sales of copper within the Chilean domestic market were directed by the Department, including the specification of price and the designation of individual purchasers.

63. All importation of goods and equipment into Chile were subject to review and approval by the Department, which approval was frequently denied in order to compel the companies to purchase goods manufactured or produced within Chile.

64. All major capital expansion and development projects in Chile were initiated through a process of negotiation and mutual planning with the Department, which in turn supervised the execution of the project to see that the original undertaking was carried out.

65. All commercial transactions between Anaconda's Chilean companies and the Anaconda companies in the United States were subject to audit by the Department to ensure that intercorporate transfers were conducted on a basis acceptable to the Chilean government.

66. A Department representative was stationed permanently at each of the mines and technical personnel from Department headquarters in Santiago frequently visited the mines to investigate operating conditions and determine compliance with development programs conducted under so-called "investment decrees".

67. And finally, the amount of capital reserves maintained by the companies on deposit in Chile was subject to the control of the Department, which from time to time caused the Chilean Executive to issue a decree indicating the amounts of dollars that each company was required to bring into Chile to pay for local expenditures.

68. In addition to such controls exercised by the Copper Department, the 1955 Law also continued in effect the high rates of corporate income taxation applicable solely to the *Gran*

Mineria.[1] The basic rate was thus set at 50 percent of net income, to which was added a variable surtax of 25 percent. The surtax was subject to reduction as the copper output of the companies exceeded average production over the five year base period 1949-1953. In the event, however, that yearly production fell below this five year base figure, the tax was increased to an overall rate of 80 percent. As actually applied, this scheme resulted in Chilex paying Chilean income taxes at rates in excess of 60 percent of net income (as defined for Chilean tax purposes) throughout the years at issue. All such taxes were levied on an unapportioned basis, against the entire net income of the Chilean companies, without adjustment for taxes paid to any other state or nation.

69. Originating with the 1955 Law, the above described tax and regulatory regime continued in effect until 1966. Thereafter, a similar regime existed through 1969, based upon supplementary legislation enacted by the Chilean Congress in 1966. While this new legislation increased the powers of the Copper Department in several important respects,[2] it generally perpetuated the basic structure of comprehensive government control instituted by the 1955 Law. Similarly the 1966 Law preserved the taxing scheme adopted in the 1955 Law, with a small upward adjustment in the tax rates.

70. In the period immediately preceding enactment of the 1966 Law, however, a significant further development occurred companies, [sic] the 1964 Chilean presidential candidate, Eduardo Frei, campaigned on a platform of increased Chilean participation in the *Gran Mineria,* called "Chileanization". Frei's copper strategy was to obtain further concessions from the companies by means of negotiated contractual arrangements rather than by primary reliance on legislation. Having

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[1] Some relief was granted, however, to new investments such as the Andes El Salvador mine.

[2] Among the additional powers conferred on the Department by the 1966 Law were: (a) the power to compel the companies to reinvest earnings in Chile; (b) the power to assess penalties for failure to comply with Department orders; and (c) the power to declare a national monopoly of the export of all Chilean copper in the event of "exceptional situations which jeopardize the national interests" Law 16,624 (Plaintiff's Exhibit N-8).

promised that such negotiation would lead to Chilean participation in the formal ownership of the mines, Frei called for meetings with the companies immediately after his election in September of 1964.

71. In response to Frei's demands, Kennecott announced shortly thereafter that it would agree to formal Chileanization and would sell to the government a majority interest in Braden. Anaconda's Chilean companies, in turn, were prevailed upon to make a number of parallel concessions which resulted in a negotiated undertaking dated December 12, 1964 between the companies and the government of Chile. This Agreement was subsequently reduced to a shortened form for publication on December 18, 1964. The Chilex and Andes Agreement, along with the Kennecott sale, thus became the basis of a Chileanization program which President Frei then took to the Congress for legislative ratification and implementation.

72. In substance, the 1964 Agreement consisted of a large-scale capital expansion plan together with an undertaking to form several mixed ownership companies (called mixed mining companies) corresponding to the mixed mining company to be created out of the Kennecott subsidiary. The general spirit and intent of the Agreement, however, as stated in Article I, was to provide for "an ample association [between the State and the companies] in the determination and direction of the commercial policy to place copper . . . on the market, and new procedures to extend methodically the purchase of nationally manufactured products that will be used in the investments and operations, and other matters in which the State and [the] Companies will collaborate".

73. More specifically, the Agreement required Chilex and Andes to invest approximately $145 million (U.S.) in Chile to expand the companies' copper production by about 50 percent. The companies also undertook to greatly enlarge their refining capacity in Chile so that the major portion of electrolytic refining of Chilean production would be performed locally. In addition, to further promote downstream operations in Chile, the Agreement required that copper reserves be established and maintained by the companies for sales to national industries in the domestic market. As under the 1955 Law, it was provided

that such sales would be regulated and controlled by the Copper Department with the object of encouraging the establishment of independent fabricators in Chile.

74. Finally, the Agreement embodied the goal of formal state ownership by providing for the creation of two mixed mining companies, Exotica Copper Company and Cordillera Exploration Company. In the case of Exotica, Chilex agreed to form a mining company 25 percent owned by the state and 75 percent owned by Chilex to develop Exotica ore reserves adjacent to the main Chilex mine at Chuquicamata. Similarly, Andes and Chilex jointly agreed to form at some later date a prospecting and exploration company, to be called Cordillera, which would be 49 percent owned by the state and 51 percent owned by Chilex or Andes. While subsequent developments prevented the formation of this latter company, the plans for Exotica did in fact proceed according to the Agreement, and a mixed company was created and placed into operation in joint ownership with the Copper Department. In addition, the other undertakings contemplated by the 1964 Agreement were subsequently performed by Andes and Chilex with the ongoing participation of the Copper Department.

75. Notwithstanding such efforts on the part of the companies, however, still further demands were made by the government beginning in about 1966. In this regard, the 1966-1967 period represented an extremely volatile time in the international copper industry, with expansionary pressure throughout the world driving copper prices to record highs. The period also brought increased conflict between the companies and the Chilean authorities over pricing policy on the international market, the government seeking to maximize immediate returns by responding to shortages with ever higher prices and the companies in turn urging a more moderate and long-term approach. This conflict resulted in the price of Chilean copper being set unilaterally by the Copper Department and imposed by law on the producing companies. Reflecting a much higher price than that charged by Anaconda in the United States, the Chilean government's action was directly contrary to the pricing policies of the producing companies.

76. In addition, along with dictating higher prices, the Copper Department also claimed a direct right to a portion of the increased earnings. These demands led to a "Memorandum of Understanding" with the companies dated July 8, 1966 whereby the Copper Department became entitled to direct participation in the sales proceeds of Chilex and Andes.

77. In an arrangement similar to the old Central Bank monopoly of the 1952-1955 period, the Memorandum provided that the Copper Department would purchase from the companies 30.55 percent of the combined production of Chilex and Andes for the period July 1, 1966 through December 31, 1966. The price to be paid by the Copper Department was set at 42 cents per pound, a figure representing a 20 cents discount from the world price of 62 cents per pound existing at the time of the agreement. Simultaneously with the discounted sale to the Copper Department, however, Anaconda Sales, the sales representative of the companies, became obligated to repurchase the copper from the Copper Department at the "then existing [world] market price for deliveries of Chilean copper established by [the Copper Department]". The net result was that on approximately a third of the total production of Chilex and Andes, the Copper Department acquired a direct contractual right to all ultimate sales proceeds received by Anaconda Sales in excess of 42 cents per pound. In monetary terms, this meant a diversion of approximately $23 million of corporate earnings to the Copper Department over the six month period of the agreement.

78. A second example of government financial participation in the years following the 1964 agreement was the "compulsory loan" device introduced by the Readjustment Laws of 1968 and 1969. The rationale behind this measure was that earlier government decrees had offered the companies a twenty year guaranteed tax rate at a level not exceeding that established by the 1966 law in return for the capital expansion rate at a level not exceeding committed under President Frei's Chileanization Program. Rather than openly repudiate such a guarantee and amend the tax law, the Chilean Congress enacted a 13 percent surtax in the form of a compulsory loan to

the national treasury. In view of the manner in which the loan was applied, however, the 13 percent payment was in fact more unfavorable to the companies than a direct and undisguised tax.

79. Thus, the 1968 loan was to be "repaid to the taxpayers in five equal installments during the tax years 1970, 1971, 1972, 1973 and 1974 by crediting to the taxes that the taxpayers must pay in said tax years." Similarly, the 1969 loan was to be credited against taxes becoming due in 1971, 1972, 1973, 1974 and 1975. However, the companies were not allowed interest on such prepaid taxes; and in addition, while the payment had to be made in U.S. dollars, the tax credit was computed in Chilean escudos at the rate of exchange existing in the year of payment. This resulted in a significant exchange loss as the escudo was periodically devalued over the term of the loan.

80. In all, Andes and Chilex paid approximately $26 million in such interest-free loans in 1968 and 1969, with a substantial additional loss incurred through devaluation. As in the case of the 1966 Memorandum of Understanding, this device was imposed in addition to the regulatory regime administered by the Copper Department, which continued in effect throughout the 1955-1969 period.

81. In 1969, however, the companies were presented with a new set of government demands. In the same manner as the regulation of the *Gran Mineria* had come under political attack in 1964, President Frei's Chileanization Program came under increasing political cross-fire in late 1968 and 1969 as the 1970 presidential election year approached. Notwithstanding the fact that the companies had fully complied with all of their investment undertakings and were generating tax revenues at an unprecedented level, the Frei administration was eager to present to the electorate a formal transfer of ownership in the companies in order to stem leftist demands for full-scale expropriation. President Frei therefore summoned the companies to negotiations in May of 1969. A Memorandum of Agreement was subsequently announced on June 26, 1969 whereby the government in effect agreed to acquire all of the Anaconda interests in Chile on a long-term installment sale basis.

82. Under the 1969 Agreement, Andes and Chilex undertook to transfer all of their assets to two new mining companies to be organized on January 1, 1970. The government, in turn, agreed immediately after such transfer to purchase from Andes and Chilex at book value 51 percent of the stock in the newly created companies for notes payable over a twelve year period. The government also agreed to purchase the remaining 49 percent of the stock at some later date during the same twelve year period. The sales price of this latter block of shares was set at a multiple of earnings varying according to the year in which the government elected to complete the transfer (e.g. if the sale were executed in 1973, the multiple was set at 8; if executed in 1974, 7.5, and so forth). The price of the 49 percent interest was similarly payable on an installment basis over an additional twelve year period.

83. In effect, therefore, the 1969 Agreement provided for the creation of two new mixed mining companies to replace Andes and Chilex. The government was to acquire a majority interest in each new company at the outset, as well as the further right (and obligation) to take over entirely at some future date. During the period of joint ownership, however, it was agreed that the operating relationships between the parties were to remain unchanged, and that the by-laws of the new companies would contain voting provisions protecting the Andes and Chilex minority interests. In addition, it was provided that "A contract for assistance shall be executed between the new mining compan[ies] and Andes and Chilex or other subsidiaries of Anaconda, which shall contribute all their knowledge and technology in the various fields of operation and management, for the technical direction and operation of the ore bodies and mining establishments." In the latter part of 1969 and the early months of 1970, such a transition was accomplished without noticeable change in the day to day operations of the mines at El Salvador and Chuquicamata.

84. In September of 1970, on the other hand, the situation changed dramatically. The Christian Democratic Party under President Frei's successor failed to obtain a plurality in the national elections, leaving a new government to be formed by a coalition of leftist parties under the leadership of Dr. Salvador Allende Gossens. Upon taking presidential office on November

3, 1970, Allende announced his intent to expropriate the foreign producers, whereupon the Copper Department sought to assume exclusive responsibility for the operations of the *Gran Mineria* in Chile. Thereafter, on July 16, 1971, legislative approval of the Allende program was obtained in the form of a constitutional amendment providing for expropriation, followed by implementing decrees issued by the Executive on July 17 and September 28, 1971. As proclaimed in the September Decree, Chile thereby exercised "[a] right, universally acknowledged today, . . . to nationalize the Major Copper Mining Enterprises . . . on equitable social terms, theoretically justified and scrupulously enforced."

85. In substance, the Constitutional Amendment provided that, "The State has absolute, exclusive, inalienable and imprescriptable ownership over all mines" in Chile. Accordingly, the producing companies were not entitled to compensation for their property interests in the minerals-in-place, but only for their plant and equipment which were not owned "absolutely" and "exclusively" by the State. In this regard, however, the Amendment provided that in computing the compensation to be paid to the companies, a deduction was to be made "for all or part of the excess profits earned by the nationalized companies and their predecessors annually beginning with the entry into force of Law 11,828 [in 1955], giving special consideration to the normal profits they have obtained in their international operations as a whole . . . ." As explained in the subsequent September Decree, such provision for "excess profits" was intended to "[rectify] an historic past that permitted the exploitation of basic natural resources of major copper mines by private investors, without adequate legislation to preserve to the State its right to receive the benefits of said exploitation. . . ."

86. The result was that Andes and Chilex were credited with $364 million of "excess profits" for the period between May 5, 1955 and December 31, 1971. As applied to the above-described compensation formula, such a credit in favor of the companies meant that in fact the government of Chile, after expropriation, was still due the sum of approximately $62 million. In unilateral settlement of the account, the instalment

obligations owed to the companies under the 1969 Agreement were cancelled, leaving the government as the sole shareholder of the new mining companies. In addition, the compulsory loans assessed in 1968 and 1969 were never repaid. No further compensation was offered by the Allende government, nor was any obligation acknowledged, despite the continued claims of the companies.[3]

87. Anaconda's interests in Chile were thus terminated as the mines once owned by Andes and Chilex came under the exclusive ownership and control of the Chilean government.

(vii) The Effects of Government Control in Chile

88. The overall effect of the controls described above was that the Chilean government itself became a full fledged participant in the business of Anaconda's Chilean companies. Even prior to its acquisition of a stock interest in 1969, the government exercised such *de facto* ownership rights that Anaconda cannot be said to have possessed the unilateral powers of policy making and operational control normally exercised by a majority stockholder with controlling ownership. While the Anaconda domestic group in the United States was linked together by a single ownership interest, this linkage did not extend to the Chilean companies which at all times were responsive to the dual interests of the Chilean government and the parent company.

89. That the government in effect acted as a joint participant or co-owner throughout the 1955-1969 period is clearly demonstrated by the fact that the acquisition of formal majority ownership under the 1969 Agreement did not lead in practical terms to any significant changes in the method and manner of government control. Thus, in the period immediately preceding the 1971 expropriation, the copper business of Andes and Chilex, formerly conducted under the majority ownership of Anaconda, continued without interruption under government

[3] Following the fall of the Allende Government in 1973, however, settlements were reached with the new government of Chile and with the United States Overseas Private Investment Corporation, which resulted in Anaconda obtaining partial compensation for its 1971 expropriation loss.

majority ownership, subject to the precise same regulatory regime administered by the Copper Department as had existed prior to 1969. There was no significant increase in government control because ownership-type control had existed all along. Moreover, majority ownership brought no significant increase in government financial participation, since the government's newly acquired dividend interest was roughly equivalent to its taxing interest existing prior to 1969.

90. The overall effects of government control during the 1955-1969 period can also be seen in a number of specific instances where Chilean government policies prevailed over the policies advocated by the companies. These include:

(a) The fact that during the late 1950's and early 1960's, and particularly as a result of the 1964 Agreement, the companies were required to develop greatly increased refining capacity in Chile, notwithstanding that Chilean production could be refined more economically in Europe or at the existing International Smelting and Refining facility in New Jersey.

(b) The fact that the Chilean companies were required to purchase an increasing percentage of their equipment and operating supplies from Chilean sources although more economical and higher quality sources were available abroad.

(c) The fact that as a result of the 1964 Agreement Chilex was forced to proceed with the development of the Exotica ore reserve (to be mined by Exotica Copper Company) in a manner and at a time considered inappropriate by the companies.

(d) The fact that throughout the 1955-1969 period, the Chilean companies were required to sell production to local Chilean fabricators at a discounted price.

(e) The fact that after 1965 Chilean copper was sold, pursuant to the marketing policies of the Chilean government, at the highest world price available despite the contrary policy of the companies that more stable long-term pricing was necessary to successfully market copper and to discourage use of substitute products.

(f) The fact that the Chilean government required the companies to follow a market strategy of wide distribution, promoting sales throughout the world, whereas the companies preferred that sales be directed toward a more limited and established market.

(g) The fact that the Chilean government consistently exhibited a lack of confidence in the U.S. market despite the contrary view of the companies; and [sic]

(h) The fact that through day to day association with the Copper Department, the companies were placed in the position of transferring valuable marketing know-how and other expertise to the government without any guarantee that such information and training would not ultimately be used against the companies (as in fact it was).

Taken as a whole, such an array of outcomes in favor of the Chilean government indicates that the government's public interests generally prevailed over Anaconda's shareholder interests throughout the 1955-1969 period. In view of such results, it cannot be concluded that Anaconda at any time possessed undivided majority control over the policies and operations of its Chilean companies.

(vii) [sic] Government Control in Mexico

91. As previously indicated, Cananea held its mining properties in Mexico under concessions from the federal government. In accordance with the Constitution of Mexico, all underground minerals were the exclusive property of the Nation and could only be mined or exploited under contractual arrangements undertaken with the government. While such contractual arrangements defined the nature of Cananea's property interests, they did not provide explicitly for royalties or production shares to be paid to the government. Instead, under Mexican law, royalties were paid in the form of production taxes, which were assessed against the company in addition to the regular Mexican corporate income tax.

92. Apart from participating in the earnings of the company, the Mexican government exercised extensive statutory controls in order to promote industrial development in Mexico

and encourage local Mexican ownership of the nation's mining companies. With the Mexican domestic market for copper expanding rapidly (at approximately 10 percent per year) through the 1955-1969 period, the primary function of the government with respect to copper in particular was to ensure that a local source of supply would be available on a priority basis at a controlled price to meet the demands of Mexican industry.

93. The statutory means of effecting this result was provided by the 1950 "Law Relating to Powers of the Federal Executive in Connection with Economic Matters." Under this legislation, the government was given a broad range of regulatory powers designed to foster economic development. Such powers extended over "articles of food", "articles of clothing", "articles produced by important branches of Mexican industry" and most importantly "essential raw materials for activities of the national industry." This latter category included the copper produced at the Cananea mine. The operative sections of the Law, in turn, provided as follows:

> "*Article 9.* The Federal Executive is authorized to impose restrictions on the importation or exportation of articles whenever the economic conditions of the country and the better supplying of its needs so require."

Along the same lines, Article 10 provided that:

> "Producers who export raw materials or manufactured articles are firstly obligated to meet the demands of domestic consumption, on the understanding that, in such cases, the price in the interior of the country cannot be higher than the price of the articles in question on foreign markets, after deducting taxes, freight charges, insurance and other expenses necessary to sell such articles abroad."

In effect, the Federal Executive was thereby authorized to regulate imports and exports in much the same fashion as the Copper Department in Chile. Of even more immediate impact, however, a producer of raw materials such as Cananea was required to meet the demands of local industry, at a controlled price, before selling on the world market.

94. It was in large part as a result of this 1950 Law that Cananea remained almost entirely a Mexican domestic operation during the years at issue in this action. Pursuant to the priority requirements of Article 10, the company sold most of its production in the form of blister (i.e. unrefined) copper to Cobre de Mexico which was owned in part by the Mexican government. Cobre in turn sold refined copper primarily to fabricators in Mexico in accordance with the government's policies. As indicated in the above-quoted Article 10, moreover, the price at which sales were made to Cobre was subject to government regulation to ensure that "the price in the interior of the country [was not] higher than the price . . . on foreign markets.[4]

95. In addition, Cananea's purchasing activities were subject to regulation pursuant to the government's authority under Article 9 to approve imports. The purpose of controls in this area was to promote and sustain local industry, as well as to administer Mexico's external balance of payments. Accordingly, import permits were issued only for articles which were not available locally. In many cases, this meant that Cananea was forced to pay a local price higher than the world market Price, or was required to obtain domestically produced items of lesser quality. As with the regulation of sales, the net result of this government policy was that Cananea's purchasing operations were increasingly confined to Mexico. The company's contact with the world market as a source of supplies was limited, as was its contact with world export markets.

96. A final element contributing to the insularity of the Mexican operations was the major legislation enacted in 1961 to reorganize the nation's mining industry. Having previously amended the federal constitution to further delineate the concessionaire nature of all mineral holdings within Mexico, the

[4] Mexico also discouraged the export of blister copper and refined copper by levying a high export tax designed to offset the price advantages of selling on the world market. This tax was set at about 15 percent of the export price during the 1955-1969 period. But, since the 1950 Law required that sales within Mexico be discounted to reflect the fact that no export tax was paid, this in effect meant that copper had to be sold within Mexico at a price at least 15 percent below the world market price.

National Congress followed with the so-called "Law Regulating Constitutional Article 27" which became effective April 20, 1961. The Law constituted a turning point in Mexican mining history, for it provided a comprehensive scheme of establishing, developing and operating concessions granted by the federal government. Of more significance to Cananea, however, the legislation required the "Mexicanization" of all concession holders, stating in Article 14 that "Only Mexicans and companies formed pursuant to Mexican laws, the majority of whose capital has been subscribed by Mexicans, have the right to obtain the concessions referred to in this Law."

97. As for concessionaires, such as Cananea, which were not Mexican owned, the Law provided that all concession rights would expire in 25 years unless a prior transfer of ownership were accomplished. Furthermore, as an incentive for immediate Mexicanization, accompanying legislation granted a 50 percent reduction in the substantial federal production and export taxes to mining companies which were locally owned. Thus, an American held producer such as Cananea was faced with a tax burden at least twice as high as that paid by competing Mexican producers, in addition to being presented with the certain loss of all mining rights at the end of 25 years.

98. The response of Anaconda to such measures was either to Mexicanize Cananea immediately if a favorable market existed for its stock or, if not, to delay for a moderate period in order to realize some operating return on *existing* investments. In no event, however, could a concessionaire afford to wait the full 25 year period; for (notwithstanding the heavier production and export taxes) as the deadline approached, it was obvious that the only possibility, other than forfeiture, would be sale at a sacrificed value. Similarly, for the period a concession was retained prior to Mexicanization, there was no incentive for further long-term investment or market development. Under either withdrawal strategy, the most an investor could hope for was to derive some benefit from commitments undertaken before enactment of the 1961 Law.

99. In the case of Cananea, nearly ten years intervened before an acceptable Mexicanization arrangement was possible. During this period, the company continued on as before,

operating largely in a holding pattern awaiting the appropriate time to Mexicanize. While normal upkeep was maintained and pre-1961 projects were completed, no large-scale new expansion was undertaken, or was any effort made to integrate the Mexican operations with Anaconda's U.S. domestic business. As a result of the uncertain future of the company, combined with the operating controls to which it was subject, Cananea remained a wholly local enterprise throughout the 1955-1969 period.

100. Finally, in 1971 Cananea was duly Mexicanized by means of a transfer of 51 percent of its stock to Mexican interests. Such interests included a 26 percent share to the Mexican government, a 5 percent share to Cobre de Mexico (in which the government held a 38 percent interest), a 5 percent share to the Banco Nacional, and 3 percent in stock options for Mexican employees. In addition, the government acquired a further 12 percent interest in escrow for eventual sale to individual Mexican investors. At the present time, however, this latter stock is still held in part by the government, which in effect owns 34 percent of the Mexicanized company. The net result of Mexicanization, therefore, was a transfer of a significant ownership interest to the host country government.

(viii) [sic] The Effects of Government Control in Mexico

101. On the basis of the foregoing, it is apparent that government control in Mexico had basically two effects during the years at issue: first, such control severely limited the opportunity for Cananea to expand its operations and relationships beyond the Mexican domestic economy; and secondly, after 1961 such control effectively deprived Anaconda of the investment and planning prerogatives normally associated with exclusive majority ownership. Essentially condemning Cananea's operations to a short-term venture as long as the company remained majority owned by foreign interests, the 1961 Law forced Anaconda to retain Cananea in a *status quo* condition (except for the completion of developments undertaken prior to 1961) until Mexicanization could be achieved. Both Cananea's lack of new development in the 1960's and its

lack of integration with Anaconda in the United States throughout the 1955-1969 period were thus a direct result of the policies pursued by the Mexican government.

G. THE FRANCHISE TAX ASSESSMENTS AT ISSUE

102. The California franchise taxes at issue in this action were assessed against Anaconda, Anaconda Aluminum, American Brass, Wire and Cable, and Anaconda Electronics. Each of these companies was doing business in California for at least a portion of the 1955-1969 period and each company was a California taxpayer. Since the time of the assessments, however, the latter four companies have all been merged into Anaconda. Accordingly, Anaconda is appearing in this action both on its own behalf and as successor to its merged affiliates.

103. In computing and affirming the assessments at issue herein the Franchise Tax Board took a number of steps which are disputed by Anaconda. These include the following:

(a) The Franchise Tax Board determined under Revenue and Taxation Code Section 25101 that a single unitary business existed as between the Latin American companies (together with Chile Copper and Greene Cananea) and the Anaconda group of companies doing business in the United States. The Board therefore combined the income of such Latin American companies with the income of the Anaconda domestic group for purposes of formula apportionment to California.

(b) Such formula apportionment in turn was accomplished by means of the standard three factor formula consisting of the factors of payroll, tangible property and sales. This formula was not adjusted in any way for variations in Latin American productivity values or for any other economic variations between the United States and Latin America. Instead, the Franchise Tax Board applied the formula to the income of the combined U.S. and Latin American group in exactly the same manner as it would have had the Latin American companies been doing business only in the United States.

(c) In accordance with its interpretation of Revenue and Taxation Code Section 24345 and in keeping with its normal treatment of multinational corporate groups, the Franchise Tax Board made no adjustments whatsoever for any corporate income or production taxes paid by the Latin American companies to Chile or Mexico. Also the Board made no adjustments for any of the other forms of host country participation described in the preceding sections of these Findings.

104. On the basis of such assessments, and after lengthy administrative proceedings delayed in part to await the outcome of a companion case (*Chase Brass and Copper Company v. Franchise Tax Board,* 10 C.A.3d 496, 87 Cal.Rptr. 239 (1st Dist. 1970)) which the Board was litigating with Kennecott, Anaconda paid under protest additional California tax and interest in the full amount alleged by the Franchise Tax Board to be due. Anaconda thereupon submitted to the Board claims for refund in the following amounts:

Income Year	Amount	
1955	$ 61,611.82	plus interest
1956	70,113.75	plus interest
1957	28,655.85	plus interest
1958	28,259.75	plus interest
1959	190,771.43	plus interest
1960	211,243.50	plus interest
1961	201,656.44	plus interest
1962	218,524.13	plus interest
1963	239,423.83	plus interest
1964	167,696.11	plus interest
1965	186,506.55	plus interest
1966	237,030.95	plus interest
1967	456,792.95	plus interest
1968	480,114.42	plus interest
1969	592,694.84	plus interest
Total	$3,371,096.32	plus interest

In addition, as a result of amended returns previously filed with the Franchise Tax Board, Anaconda had other claims for refund before the Board in the following amounts:

Income Year	Amount	
1955	$18,509.00	plus interest
1956	15,145.00	plus interest
1957	18,599.00	plus interest
	$52,253.00	plus interest

105. All such claims were based on a computation of the California franchise tax which excluded the Latin American companies (together with Chile Copper and Greene Cananea) from the Anaconda unitary business group. The claims for refund conceded, however, that the Anaconda domestic group of companies constituted a single unitary business. Anaconda thus contended that the proper method of tax computation consisted of allocating to California (by means of the standard three factor formula) a portion of the unitary business income of only the Anaconda companies operating within the United States. In making such claims, Anaconda relied (*inter alia*) upon the Court of Appeals' ruling in *Chase Brass and Copper Company, supra,* in which the Franchise Tax Board was rebuffed in a similar attempt to unitize Braden Copper Corporation, Kennecott's identically situated Chilean mining subsidiary.

106. Upon the Franchise Tax Board's denial of each and every one of Anaconda's refund claims and upon the further action of the California State Board of Equalization with respect to certain of such claims, this refund action was commenced in accordance with California Revenue and Taxation Code Sections 26102 and 26103. In bringing such action, Anaconda has complied with all statutory and administrative requirements with respect to the claims and causes of action at issue herein.

CONCLUSIONS OF LAW

1. Any and all conclusions of law hereinabove included in the statement of the Court's Findings of Fact are hereby adopted as part of the Court's Conclusions of Law. Any and all Findings of Fact hereinafter included in the statement of the Court's Conclusions of Law shall be considered as part of the Court's Findings of Fact.

2. The mutuality relationship of dependency or contribution required for a single unitary business under California Revenue and Taxation Code Section 25101 was not present during the years at issue as between Anaconda's Latin American companies (together with Chile Copper and Greene Cananea) and the Anaconda domestic group of companies doing business in the United States.

3. Similarly, the unities of use and operation required for a single unitary business under Revenue and Taxation Code Section 25101 were not present as between the Latin American companies (together with Chile Copper and Greene Cananea) and the Anaconda domestic group.

4. Moreover, irrespective of any other aspects of the relationship between the Latin American companies and the Anaconda domestic group in the United States, unity of ownership and control did not exist between the Latin American companies and the domestic group due to the continuous and pervasive intervention of the respective host country governments of Chile and Mexico.

5. The failure of the Latin American companies to meet the requirements unity under Revenue and Taxation Code Section 25101 is sustained as a legal matter by the decision of the District Court of Appeal in *Chase Brass and Copper Company v. Franchise Tax Board, supra,* which held, under circumstances nearly identical to those in the present case, that Kennecott's Chilean subsidiary (Braden Copper Corporation) was not unitary with the Kennecott domestic group of companies doing business in the United States.

6. Accordingly, the Court concludes that Anaconda's Latin American companies (consisting of Andes, Cananea, Chilex and Santiago Mining), together with Chile Copper and Greene

Cananea, were not engaged in a unitary business with Anaconda, Anaconda Aluminum, Anaconda Electronics, American Brass, Wire and Cable, Anaconda Sales, and International Smelting and Refining collectively, or with any one or more of them, or with an other Anaconda affiliate during all or any part of the period at issue. It was therefore improper for the Franchise Tax Board to compute the California income of Anaconda and its affiliates doing business in of such companies with the net income of any of the above-mentioned Latin American companies (together with Chile Copper and Greene Cananea).

7. The proper method of California tax computation for the income years at issue was to combine the net business income of only the Anaconda domestic group of companies doing business in the United States and to apportion a part of such income to California by means of the standard three-factor formula.

8. In view of the foregoing conclusions of law, the Court deems it unnecessary to determine any of the following additional issues presented by plaintiffs:

(a) Whether the Franchise Tax Board's standard three-factor formula was the proper one for apportioning unitary business income to California under assessments which included the Latin American companies within the California unitary group;

(b) Whether the Franchise Tax Board's assessments correctly stated net unitary business income on the basis of a California unitary group which included the Latin American companies;

(c) Whether the Franchise Tax Board's assessments violated the Commerce Clause of the United States Constitution; and

(d) Whether the Franchise Tax Board's assessments violated the Equal Protection and Due Process provisions of the United States Constitution and the Constitution of the State of California.

9. Plaintiff is entitled to judgment, on the basis of its claims for refund and amended returns, in the amount of $3,423,349.32, plus $1,802,472.56 in interest thereon up to and including May 1, 1979 as allowed by California Revenue and Taxation Code Section 26107. Plaintiff shall be entitled to further interest from and after May 1, 1979 on said amount of $3,423,349.32 as provided by said law.

10. Plaintiff shall recover its costs of suit.

Let judgment be entered accordingly.

DATED: June 1, 1979.

ROBERT J. DREWES
Judge of the Superior Court

APPENDIX D

COURT OF APPEAL OF THE STATE OF CALIFORNIA
IN AND FOR THE
FIRST APPELLATE DISTRICT
DIVISION FOUR

THE ANACONDA COMPANY, ETC., *Plaintiff and Respondent,*	
VS.	**No. 48666**
THE FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Defendant and Appellant.*	**San Francisco 696859 Superior Court No. 687073**

BY THE COURT:

Rehearing is granted to permit full consideration of the points raised in respondent's petition for rehearing. The cause is submitted.

The Attorney General may respond to the petition by letter to be refiled not later than January 11, 1982.

Dated: *December 28, 1981*

CALDECOTT, P.J.

APPENDIX E

ORDER DENYING HEARING
After Judgment by the Court of Appeals
1st District, Division 4, Civil No. 48666

IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA
In Bank

Anaconda Company

v.

Franchise Tax Board

Respondent's petition for hearing DENIED.
(Marked Filed by Court Clerk May 26, 1982)

Bird
Chief Justice

APPENDIX F

Peter Anderson
R. Tyler Andersen
Fred A. Rodriguez
THELEN, MARRIN, JOHNSON & BRIDGES
Two Embarcadero Center, Suite 2200
San Francisco, California 94111
Telephone: (415) 392-6320

IN THE COURT OF APPEAL
OF THE
STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT
DIVISION FOUR

THE ANACONDA COMPANY, a corporation, on its own behalf and as successor by merger to ANACONDA AMERICAN BRASS COMPANY, ANACONDA WIRE AND CABLE COMPANY, ANACONDA ALUMINUM COMPANY, AND ANACONDA ELECTRONICS COMPANY, *Plaintiff and Respondent,* vs. THE FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Defendant and Appellant.*	**1 Civil No. 48666**

(Marked Filed by Court Clerk July 9, 1982)

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that The Anaconda Company, the Plaintiff and Respondent above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Court of Appeal of the State of California entered on March 24, 1982 (Petition for Hearing denied by the Supreme Court of California on May 26, 1982), reversing the judgment of the Superior Court of the State of California, in and for the City and County of San Francisco.

This appeal is taken pursuant to the 28 U.S.C. §1257(2).

Dated: July 9, 1982.

Peter Anderson
R. Tyler Andersen
Fred A. Rodriguez
THELEN, MARRIN, JOHNSON & BRIDGES

By PETER ANDERSON
Peter Anderson
Counsel for Plaintiff and Respondent

APPENDIX G

For the tax years 1955 through 1966, California Revenue and Taxation Code Section 25101 provided as follows:

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State. Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, payroll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State.

In 1966, Section 25101 was changed pursuant to California's adoption of the Uniform Division of Income for Tax Purposes Act (the "Uniform Act"). Applicable to income years beginning after December 31, 1966, the law in its present form reads as follows:

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with section 25120 of this chapter); provided, however, that any method of apportionment shall take into account as income derived from or attributable to sources without the state, income derived from or attributable to transportation by sea or air without the state, whether or not such transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country.

Article 2, in turn, includes the same type of provisions for formula apportionment as provided in Section 25101 of the former law. In relevant part, these provisions are as follows:

Section 25120. Definition of terms used in "this act"

As used in Sections 25120 to 25139, inclusive, which shall hereafter be referred to as "this act," unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. . . .

Section 25121. Income taxable both within and without state: Allocation and apportionment

Any taxpayer having income from business activity which is taxable both within and without this state shall allocate and apportion its net income as provided in this act.

Section 25128. Formula for apportioning business income to state

All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Section 25129. Formula for determining property factor

The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the income year.

Section 25132. Formula for determining payroll factor

The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the income year by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the income year.

Section 25134. Formula for determining sales factor

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the income year, and the denominator of which is the total sales of the taxpayer everywhere during the income year.

Title 18, California Administrative Code, Section 25120 provided as follows for the tax years at issue:

(b) Two or More Businesses.—One corporate entity may have more than one "trade or business." In such cases, it is necessary to determine the business income attributable to each separate trade or business. The income of each business is then apportioned by an apportionment formula which takes into consideration the instate and outstate factors which relate to the business the income of which is being apportioned.

Example: The taxpayer is a conglomerate with three operating divisions. One division is engaged in manufacturing aerospace items for the federal government. Another division is engaged in growing tobacco products. The third division produces and distributes motion pictures for theaters and television. Each division operates independently; there is no strong central management. Each division operates in this state as well as in other states. In this case, it is fair to conclude that the taxpayer is engaged in three separate "trades or businesses. Accordingly, the amount of business income attributable to the taxpayer's trade or business activities in this state is determined by applying an appropriate apportionment formula to the business income of each business.

The determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or business will turn on the facts of each case. In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the divisions under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered

to be good indicia of a single trade or business; and the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade or business:

(1) Same type of business: A taxpayer is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a taxpayer which operates a chain of retail grocery stores will almost always be engaged in a single trade or business.

(2) Steps in a vertical process: A taxpayer is almost always engaged in a single trade or business when its various divisions are engaged in different steps in a large, vertically structured enterprise. For example, a taxpayer which explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the taxpayer's executive offices.

(3) Strong centralized management: A taxpayer which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, and purchasing. Thus, some conglomerates may properly be considered as engaged in only one trade or business when the central executive officers are involved in the day-to-day operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, and financing.